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Budget papers

The Honourable Charles MacNaughton
Treasurer and Minister of Economics

Ontario Treasury and Economic dept
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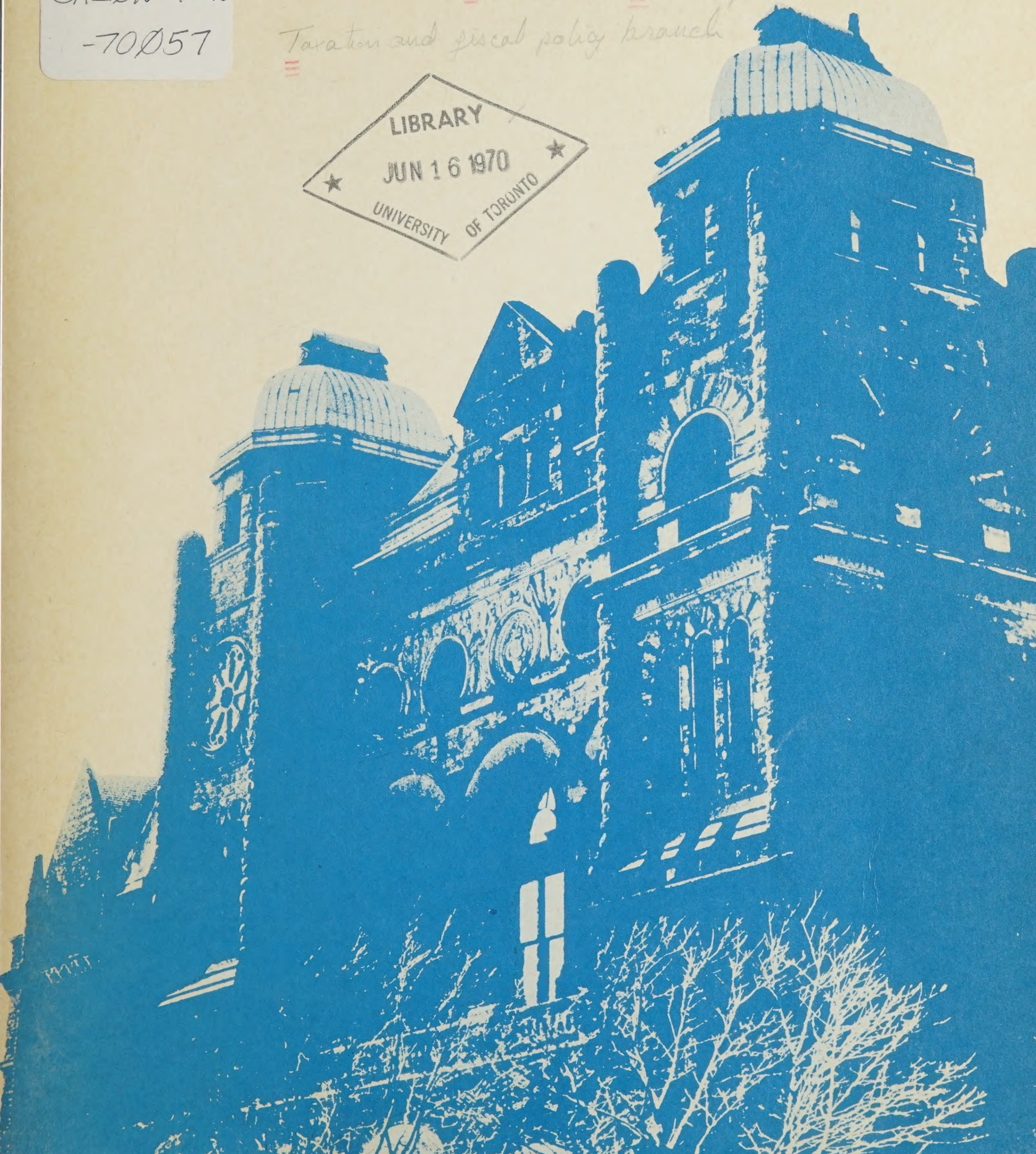

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ONTARIO

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Treasurer and Minister of Economics

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Preface

In recent years, federal and provincial governments in Canada have been engaged in discussions on the improvement of intergovernmental fiscal and financial relations. The Ontario Government believes this process is critically important in ensuring the continued effectiveness of the federal system. It has devoted considerable attention, therefore, to the development of constructive proposals which have been presented in numerous statements and working papers to federal-provincial conferences at both the ministerial and advisory levels.

The three papers contained in this volume were presented originally as budget papers with my Budget Statements to the Ontario Legislature in 1969 and 1970. They are reprinted in this volume, first, to provide a public summary of Ontario's approach to the problems of federal-provincial policy co-ordination, finance and tax reform confronting Canada today. The second purpose is to make them available in a convenient form to the federal and other provincial governments in order that they may be more readily considered at future conferences.

The first two papers are concerned with ensuring steady economic growth in Canada. The first paper emphasizes the need for new methods of federal-provincial policy co-ordination to achieve price stability without high unemployment. The second paper details Ontario's role in Canada as the main generator of federal resources for the development of other provinces. In so doing, it focuses attention on the essential interdependence of all provinces and the importance of designing fiscal policies which do not endanger Ontario's economic growth.

The third paper contains Ontario's approach to provincial-municipal tax reform. In context with the Government of Canada's tax reform proposals it underlines the need to integrate reform across the broad spectrum of federal, provincial and municipal taxes. In this, and the other papers, Ontario advances two main principles of tax reform. Unless methods can be found to contain public expenditures and reallocate revenues more effectively, attempts to increase the equity

of taxation will be nullified by increases in absolute tax levels. And similarly, unless tax reform is co-ordinated increased equity in personal income tax will be offset by tax increases in such other fields as municipal property taxation.

In addition to the budget papers in this volume, three staff papers are reprinted in an accompanying volume *Intergovernmental Policy Co-ordination and Finance*. These papers are samples of the detailed contributions Ontario officials have made to various intergovernmental conferences in recent years.

Treasurer of Ontario and
Minister of Economics.

May 1970.

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THE PUBLIC SECTOR AND ECONOMIC POLICY

This paper is presented by the Ontario Government as a first step to stimulate a broader and more intensive inquiry into the theory and practice of economic policy co-ordination in the Canadian federal system. For the past three years, Budget Paper A has provided a review and outlook for the Ontario economy. In recent months, however, public discussion of economic developments has been sufficiently thorough to make a reiteration of the basic facts unnecessary.[1] This paper will concentrate, therefore, on the larger question of the formation of public policies to reduce inflation and to achieve full employment growth and balanced development of the public and private sectors of the economy. The achievement of these fundamental goals will require new initiatives by governments.

I INFLATION AND GOVERNMENT POLICIES IN 1969

The Problem of Inflation

Like most industrial economies, Canada generated inflationary pressures as it moved towards high levels of economic growth and employment in the late 1960s. The major problem confronting Canadian governments today, however, is the persistence of strong inflation in the face of an economic slowdown, a slowdown caused largely by restrictive monetary and fiscal policies designed to reduce inflation. This apparent inconsistency of persistent inflation in the face of a softening economy indicates the existence of fundamental imbalances in the economy. The aim of this paper, therefore, is first to identify the imbalances which make inflation structurally endemic, and second to raise the question of the design and application of remedial policies.

Government Policies in 1969

In the past year, the federal government's fiscal and monetary policies have been directed almost exclusively toward the containment of inflation. Increases in federal expenditure were reduced below the growth of revenue to produce a budgetary surplus in 1969-70. A further surplus is planned for 1970-71. Credit availability has been limited and interest rates have risen sharply. In mid-1969, the federal government introduced a deferral of depreciation allowances on new commercial

[1]The highlights of Ontario's economic performance in 1969 and of the forecast for 1970 are contained in an appendix to this Budget Paper.

buildings in selected urban centres. The extension of this measure into 1970 is designed to reduce the level of construction activity, particularly in metropolitan Toronto.

At the same time, provincial and municipal governments trimmed expenditure growth in 1969-70. The difficulties of raising long-term capital and the constraints of revenue growth emphasized the need to control expenditures and to balance budgets. The net effect at the provincial-municipal level has been a reinforcement of federal fiscal and monetary policy and a deceleration of growth in the public sector.

Definite signs appeared by late 1969 that restrictive policy actions were affecting economic growth across Canada. While Gross Provincial Product in Ontario grew by 9.6 per cent in 1969, the growth rate is not expected to exceed 7.0 per cent in 1970. In Canada as a whole the growth rate is expected to fall from 9.3 per cent in 1969 to 6.8 per cent in 1970. Two difficult problems will continue to confront government economic policy in 1970. First, current monetary and fiscal policies appear to be affecting production and employment as much as prices. Second, the burden of this economic adjustment is occurring with particular severity in eastern Canada in the form of rising unemployment; in addition, there are now definite signs of rising unemployment in Ontario.

Tables 1 and 2 contrast the course of inflation and unemployment in Canada in 1969. On the one hand, Table 1 indicates a modest decline in the rate of inflation in 1969, in terms of changes in implicit GNP prices. The peak period of pressure was in the second quarter of 1969 when the overall level of inflation was equal to an annual rate of 7.5 per cent. By the fourth quarter, however, prices were estimated to be rising less rapidly, although there have been signs of continued inflationary strength in early 1970.

Table 1

Per Cent Changes in GNP Implicit Price Deflator

(Seasonally Adjusted, Annual Rates)

1968			1969			
II	III	IV	I	II	III	IV
2.8	4.0	3.6	2.9	7.5	4.5	2.2

Source: Dominion Bureau of Statistics, *National Income and Expenditure Accounts*, Ottawa, Catalogue No. 13-001.

On the other hand, Table 2 reveals a worsening in unemployment in 1969. On an annual basis the regional picture is mixed: unemployment has been increasing in Quebec and the Atlantic Provinces,

Table 2

Regional Percentage Unemployment Rates

(Seasonally Adjusted)

			1969 - Quarterly			
	1968	1969	I	II	III	IV
Atlantic	7.3	7.8	6.5	8.1	8.8	7.8
Quebec	6.5	7.0	6.3	7.0	7.2	7.4
Ontario	3.6	3.2	2.8	3.4	3.1	3.5
Prairies	3.0	3.0	2.6	2.9	3.0	3.3
British Columbia	5.9	5.0	5.0	4.5	5.1	5.4
Canada	4.8	4.7	4.2	4.8	4.9	5.1

Source: Dominion Bureau of Statistics, *The Labour Force*, Ottawa, Catalogue No. 71-001.

holding steady in the Prairie Provinces, and falling in Ontario and British Columbia. In all cases, however, unemployment was higher in the fourth quarter than it was in the first quarter of 1969.

While first-quarter data for 1970 are incomplete, current indicators point to increasing economic weakness this year. For example, the reduction in the rate of economic growth in Ontario to about 7 per cent implies an increase in average unemployment rates from 3.2 per cent in 1969 to over 4 per cent in 1970. Supporting this expectation are anticipated slowdowns in consumer purchases of durables, exports, residential construction and corporate profits. The rate of increase in prices is expected to decline nominally from 4.3 per cent in 1969 to 3.9 per cent in 1970. Such developments in Ontario will be matched by similar trends elsewhere in Canada, particularly in the Prairies, Quebec and the Atlantic Provinces.

In conclusion, Ontario and Canada have entered 1970 in a state of considerable uncertainty, with the economy showing symptoms of the early stages of a recession. In early 1969, by contrast, buoyant employment and persistent inflation presented a clearer set of targets for economic policy. Current expectations pose serious doubts about the wisdom of maintaining the single-purpose thrust of monetary and fiscal policies against inflation.

Governments must reappraise the cost of continued deflationary policies in terms of increased unemployment and below-potential economic growth. Consideration must be given to the implications of further restraint at the provincial-municipal level in terms of the accumulation of serious shortages in essential economic and social services and facilities. It is far from certain that the continued application of broadly restrictive monetary and fiscal policies will be effective

in preventing increased inflationary pressures. These questions suggest the need for a basic re-examination of the ways in which government policy instruments can be used more flexibly and selectively to achieve orderly economic growth without inflation.

II ECONOMIC STABILIZATION POLICIES IN 1970

This section examines the effectiveness of economic stabilization policies in counteracting inflation in Canada today. It underlines the urgent need for a more extensive intergovernmental analysis of existing economic policies. However, the discussion will be confined to the central issues and measures.

Present Policies of Governments

The federal government has stated its remedy for inflation: reduce the growth of aggregate demand even if this means increasing unemployment. In addition, some measures have been devised to have a special restraining influence on the growth regions of Ontario, Alberta and British Columbia. In its diagnosis of the problem, the federal government has maintained that excess demand in the growth regions is causing an inflationary surge in costs and prices that is over-lapping into other regions.

The Ontario Government made a commitment in its 1969 Budget Statement to achieve a surplus in the 1969-70 fiscal year. This policy was adopted because the economy was sufficiently buoyant to absorb anti-inflationary restraints without creating unemployment. For 1970-71 the Ontario budget is holding to a prescription of modified restraint by avoiding inflationary tax increases and new demands on domestic capital. However, it will be moderately expansionary to offset the worsening employment situation.

Budget Paper B examines the role and impact of the fiscal operations of the various levels of government in Ontario. It demonstrates that federal fiscal actions have a built-in tendency to restrain economic growth in Ontario. In times of increased federal restraint this "fiscal drag" in Ontario increases faster than in other regions. For example, in 1968-69, Ontario was subjected to a heavy burden of restraint by federal tax and expenditure policies equivalent to a 6.25 per cent loss of provincial personal incomes. In 1969-70, Ottawa's target of an overall federal surplus withdrew about $1.8 billion from Ontario businesses and residents which increased the "fiscal drag" to more than 7 per cent of personal incomes. Any further measures of economic tightening could cause increased unemployment and a recession whose repercussions would be felt throughout Canada.

The High Cost of Unemployment

The Ontario Government recognizes that the control of inflation has a high priority among economic policies. However, it does not agree that the objectives and methods of current fiscal and monetary policy are irrefutable. If the federal and provincial governments continue to retard economic growth, Canada could experience both higher unemployment and inflation as in the mid- and late 1950s. The basic strategy of price containment through tight monetary and fiscal policy measures has a number of disadvantages:

- it is economically wasteful because it puts people out of work and limits the nation's growth capacity;
- the less-developed regions suffer most;
- it hits industries indiscriminately and regardless of their direct influence on prices;
- it hurts smaller businesses and raises the cost of doing business;
- it restricts the supply and raises the cost of housing;
- it is accompanied by rising unemployment, hitting hardest at low-income earners and unorganized labour;
- it results in slower growth, lowering capacity utilization and productivity, and raising the unit costs of production;
- even if inflation is cured, the problem of the eroded purchasing power of the fixed-income groups remains unless compensation is provided.

Ontario, with a rapidly growing population and labour force, needs a continuous stream of private and public investment to create new jobs and raise living standards. Any attempt to cure inflation by creating unemployment runs counter to the Ontario Government's objective of keeping unemployment at no more than 3 per cent of the labour force. This is a reasonable economic objective and it is imperative that a more sophisticated strategy than induced unemployment be found to cure inflation. The Ontario Government is not willing to accept the view that unemployment is a just and effective way of solving the problem. The effects will fall on the lowest income-groups in the community. It is inconsistent to propose economic goals of tax equity to help these citizens, while contributing to their loss of livelihood as the price of solving inflation.

Is Inflation Caused by Goods-Producing Industries?

Inflation has not been a severe problem in most of the manufactured goods industries. There is evidence of the moderate price

behaviour in manufacturing industries in the index of consumer prices: durable goods' prices in 1969 rose by only one per cent. Prices of consumer non-durable goods, excluding food, were up by 3.1 per cent, which represented a sharp reduction from the 4.5 per cent of 1968.

The demand for consumer durable goods has weakened in recent months. Unemployment and lay-offs are increasing in those Ontario communities that rely on durable goods industries. The proposed use of consumer credit controls could reduce the already faltering demand for consumer durables. Further restrictive policies aimed at this sector could easily aggravate general recessionary tendencies.

International Factors

The international competitiveness of Canada is not immediately endangered by present inflationary trends. The major cost and price problems have been in goods and services produced largely for domestic consumption, for example, government services, construction, housing, food and personal and business services. It is likely that Canada's trading deficit on current account will be more affected by changes in economic growth here and in the United States, resulting from fiscal and monetary policies, than by an erosion of Canadian price competitiveness. The collapse of Canada's world wheat markets is of more immediate significance to the balance of payments and to regional economic health than price increases of manufactured goods.

The Regional Aspects

Federal policies are designed to deflate the Ontario economy. The recent federal budget extended the deferral of depreciation allowances on new commercial buildings in Ontario cities. Other selective measures included:

- a tighter restriction of federal spending and loan activities in Ontario than in other regions;
- persuasion of the banks to differentiate regionally in their lending policies;
- the proposal to control consumer credit, the impact of which will fall heavily on Ontario manufacturers of durable goods.

In total these policies constitute a broad, unitary-state application of economic policy rather than a co-ordinated, intergovernmental package to increase output and lessen price increases.

The inflexibility of these policies is demonstrated by their inability to resolve the problem of inflation without penalizing economic growth in Ontario, and their further inability to increase output in the under-

employed regions. High levels of unemployment have not stabilized prices in the low-growth regions. This is particularly relevant in the context of the alleged transmission of inflation from Ontario to other regions. Since little is known about inter-regional trade patterns, the assertion can neither be proven nor disproven with certainty.

A number of factors tend to produce uniform inflationary pressures in all regions. Among these are the effects of:

- monetary policy and the level of interest rates;
- the pace-setting wage and salary settlements for employees under federal jurisdictions;
- the steady increases in property taxes and provincial taxes across the country which register directly in price indexes and result in compensatory wage demands.

The use and extension of deferred depreciation allowances to cool off the construction industry must be acknowledged now as a failure. It underestimates the severe restraining effects of monetary policy and the strength and importance of service industry capacity; it has merely emerged as one more cost element in rising construction prices. This kind of device lacks real selectivity because it cannot discriminate according to local priorities. It is not likely to succeed without provincial-municipal economic planning support. The unilateral implemen tation of this measure and its subsequent failure are indicative of the urgent need for alternative methods of establishing regional economic stabilization policies.

III THE STRUCTURAL PROBLEMS OF INFLATION

This section examines some of the longer term structural problems in the Canadian economy encouraging inflation. Among these are public sector growth, the inflationary effects of tax increases, expansion of the service sector, population pressures, accelerated urbanization, and housing shortages. These longer-term structural forces are typically those which need co-ordinated long-run planning and cannot be effectively handled with short-run economic policies.

The Growth of the Public Sector

The competition between the public and private sectors in the 1960s was accompanied by intense intergovernmental competition for tax fields and unco-ordinated expansion of spending programs. Federal shared-cost programs, such as medicare, were imposed at a time when the public sector was already over-extended and unprepared to supply the required medical manpower inputs. On the finance side, the

federal white paper proposals on tax reform were introduced without consideration of the parallel problems of tax-sharing and integrated federal-provincial and municipal tax-structure reform.[2]

Public sector command of national economic resources grew from about 31 per cent of Gross National Product in 1960 to almost 35 per cent in 1969. Total government revenues, including Canada Pension Plan Funds, increased from $9.4 billion in 1960 to about $24.7 billion in 1969, an increase of 164 per cent compared to a growth in Net National Income of 104 per cent.[3] This expansion of the public sector was accomplished by bidding away resources from the private sector. This inevitably led to compensatory price and income demands in the economy at large and put pressure on labour costs in the construction and service industries.

Table 3

Expansion of the Public Sector in Canada: Public Sector Expenditures Expressed as a Percentage of Total Gross National Expenditure

	1960	1969
Public Sector Expenditures	%	%
Goods and services	18.6	19.8
Transfers to persons	8.7	11.0
Other payments	6.4	8.0
Total: (i) gross	33.7	38.8
(ii) excluding intergovernmental transfers	30.9	35.1

Source: Dominion Bureau of Statistics, *National Income and Expenditure Accounts* (unrevised), Ottawa, Catalogue Nos. 13-001 and 13-201.

Tax "Feed-Back" and Inflationary Cycles

Governments expanded their share of Gross National Product in the 1960s by raising taxes and incurring frequent deficits. In addition to the normal progressivity of personal income taxes there were increases in income tax rates, social security taxes, medical premiums, retail sales taxes, and property taxes, all of which accelerated the rate of growth of public sector revenues. Table 4 illustrates how the ratio of government tax revenues to personal income rose from 37 to 43 per cent, a structural shift that increased inflationary wage and salary demands.

[2]Ontario's views on integrated tax reform were set out in "Reform of Taxation and Government Structure in Ontario", *Ontario Budget 1969*, Ontario Department of Treasury and Economics, Taxation and Fiscal Policy Branch.

[3]Source: Dominion Bureau of Statistics, *National Income and Expenditure Accounts* (unrevised), Ottawa, Catalogue Nos. 13-001 and 13-201.

Table 4

Public Sector Revenues and Personal Income

	1960	1965	1969
1. Personal Income ($ million)	25,075	35,149	57,002
2. Public Sector Revenues ($ million)	9,360	14,729	24,745
3. Revenues as Per Cent of Income	37	42	43

Source: Dominion Bureau of Statistics, *National Income and Expenditure Accounts* (unrevised), Ottawa, Catalogue Nos. 13-001 and 13-201, public sector revenues exclude investment income, withholding taxes and federal transfers to the provincial-municipal sector.

Much of this revenue was fed back into the personal income streams, either as direct transfer payments or as benefits in the form of services. The indirect tax increases affected individuals psychologically, and registered statistically as inflation in the Consumer Price Index.[4]

While taxes are a compulsory diversion of personal and business income and savings, the public does not accept this as a non-negotiable fact. Wage, salary and fringe benefit demands, and the competitive bidding for personnel, are sensitive to tax changes for many months after they occur. There is, therefore, a dual aspect to tax changes; in the first round the taxes may register as a decline in personal disposable income; in the second round compensatory wage and salary adjustments occur in response to this reduction in disposable income. Technically, if the market place is relatively fluid, only one tax increase is required to move an inflationary wave through the entire range of goods and services. Taxes are powerful inflation generators because they apply across broad industrial and regional segments of the market rather than in isolated sectors.

Urbanization and Population Growth

During the 1960s the high-growth regions absorbed very large numbers of people. The population of Ontario grew by one-quarter and that of British Columbia by one-third. Table 5 shows the comparative changes for the various regions over the last ten years.

[4]It is a limitation of the present method of registering inflation in official statistics that, if there is an increase in public sector output which is financed by indirect taxes, then components of the Consumer Price Index will automatically increase, regardless of whether the public is "buying" an increased volume of public services with the increased taxes. In other words, if all public sector expansion in the 1960s had been financed by indirect taxes, then official statistics would have registered a significantly larger increase in the Consumer Price Index. On the other hand, if they had been financed entirely by increases in personal income taxes, the direct effect on statistical measures of consumer prices would have been zero, although the indirect effects of compensatory wage claims would have been registered in market prices at a later stage.

Table 5

Regional Population Growth in Canada — 1959-69

(thousand)

	Population		Change 1969/59	
	1959	1969	(000's)	(%)
Atlantic	1,843	2,012	169	9.1
Quebec	5,024	5,984	960	19.1
Ontario	5,969	7,452	1,483	24.8
Prairies	3,046	3,499	453	14.9
British Columbia	1,567	2,067	500	31.9
Canada	17,483	21,061	3,578	20.5
Ontario as Per Cent of Canada	34.1	35.4	41.4	

Source: Dominion Bureau of Statistics, *Estimated Population of Canada by Province*, Ottawa, Catalogue No. 91-201.

Most of this growth occurred in the large urban centres. In the decade 1956-66 the absolute population of Ontario cities of 100,000 and over increased by 1.35 million persons, whereas the total increase in population in this period was about 1.50 million persons. This continuing concentration of people and economic activities in the larger cities has generated economies of scale in many industries, but it has also produced pressures on the availability of serviced land and land prices, as is evident in the growth of apartments and high-rise office blocks. It has also demanded massive public capital outlays for schools, roads, hospitals, universities, sewage systems, parks, and recreation and conservation areas. This type of growth pressure contributed strongly to price increases over the period.

Costs in the Public Sector

In addition to the inflationary bias of public sector growth, there has also been a rapid rise in unit costs in public services over the past decade. In part, this was a result of the intense competition for skilled personnel between the private and public sectors of the economy. The public sector's requirement for teachers, nurses and professional and managerial skills rose rapidly through the 1960s in response to the need to effectively staff and manage the large number of community service facilities brought into operation. Standards of public service performance and administration were raised and the price for the necessary skills had to be met in order to attract competent staff.

The growth in service industry and public sector employment was one cause of the rapid rise in wages and salaries for these groups. However, there was also a long-run pressure to narrow wage and

salary differentials between the public sector and the commercial sector. Although more restraint in the public sector might have lessened the strength of this movement, there would still have been a catch-up thrust in "service-occupation" salaries which would have occurred regardless of the impact of monetary and fiscal policy.

Inflation in operating costs and lags in the application of new technology have been a particularly severe and difficult problem in the provision of a wide range of public services. It is therefore a high priority of current Ontario Government policy to determine and to implement long-run managerial and technical changes in public services to improve productivity and lower unit costs. The Ontario Government's Productivity Improvement Project utilizes both business and government expertise to achieve these objectives. The establishment of a federal-provincial task force on cost-effectiveness in shared-cost programs is another example of the concern in this area and of the steps being taken to remedy the problem.

The Special Importance of Housing

Wage and salary demands are extremely sensitive to trends in the price of consumer necessities, such as shelter. Rent and the costs of home ownership constitute a large proportion of most family budgets; hence, the effect of inflation on these important costs leads the consumer to adjust his wage demands accordingly.

By 1969 shelter costs were rising at 7.5 per cent a year, which was faster than any other component in the Consumer Price Index. This behaviour resulted from four factors, two of which emanate directly from government policies:

- the high cost and limited availability of mortgage money;
- the dependence of municipal governments on property taxes as a major source of revenue;
- high rates of family and household formation;
- the impact of accelerated urbanization on land prices.

Policies of monetary restraint are counter-productive in curing inflation in this sector because the basic problems are long-term in nature. The housing sector requires co-ordinated public policies at all levels of government to minimize supply bottlenecks, speculative pressures, financing delays and high tax burdens.

IV CO-ORDINATING ECONOMIC POLICY IN CANADA

This section examines some alternatives to existing crisis-oriented economic policies. In particular, it suggests that Canada should aim for steady growth in the public and housing sectors. It also

suggests the need for development of more effective and flexible policies to stabilize the private sector.[5]

The Economic Objectives of Federalism

Canada lacks national economic goals of an explicit order.[6] Currently economic and social targets are typically embodied in the piecemeal introduction of individual programs, for example, medicare, regional development and tax reform proposals. In this process the overall priorities, the available options, and the very important ramifications for the total public sector are inadequately considered. For example, the substantial build-up of federal government fiscal capacity, as a result of the combination of a high revenue growth capacity and recent tax increases, has not been linked with any revealed strategy of economic objectives. (This build-up would be accelerated by the initial revenue gains and the increased growth capacity of income taxes under the new federal white paper proposals for taxation reform.) Under these circumstances, it is not possible at the present time to develop a co-ordinated set of federal and provincial-municipal priorities within a cohesive policy framework.

The Weakness in Existing Mechanisms of Co-ordination

The difficulty of controlling inflation in Canada illustrates the fundamental weaknesses in federal-provincial co-ordination of economic policy. The Standing Committee on Finance, Trade and Economic Affairs, of the Canadian House of Commons, has made the following two points in reporting on inflationary influences:

> . . . the influence of governments at all levels needs to be examined in far greater detail. We noted that there has not been enough collaboration between the federal government and the provinces in discussing their separate spending plans.
>
> The public should be able to expect that future expenditures of governments at all levels will occur only within the context of a set of clearly established priorities based on cost-benefit analyses and that existing expenditures will be perpetuated only if they pass continuing examination that utilizes worthwhile efficiency criteria.[7]

[5]Ontario has advanced various proposals on the development of federal-provincial policy co-ordination at numerous intergovernmental conferences. See, for example, *The Purpose and Objectives of the Tax Structure Committee*, Ontario Department of Treasury and Economics, Taxation and Fiscal Policy Branch, presented to the Continuing Committee on Economic and Fiscal Matters, St. John's, Newfoundland, September 1969.

[6]See Economic Council of Canada, *Sixth Annual Review: Perspective 1975*, Ottawa, September 1969.

[7]Standing Committee on Finance, Trade and Economic Affairs, *Minutes of Proceedings and Evidence*, No. 14, second session, twenty-eighth Parliament, 1969-70.

Current economic and fiscal debates in Canadian federalism are locked in a rigid framework of confrontation. To improve this situation governments must develop basic research into new policy options and approaches. Little progress has been made in this regard since the Rowell-Sirois studies in the late 1930s. New policy systems must be more sensitive to the economic subtleties of federalism, rather than oriented to unitary-state economics. In particular, the growth of provincial and municipal responsibilities and functions must be recognized and accepted as a fact of federal life in Canada.

It is a matter of historical record that existing approaches to economic policies in Canada have been unable to achieve a lasting solution, either to long-run differences in regional growth or to short-term fluctuations in prices and business activity.[8] A modernized fiscal policy would provide greater recognition of the complexities of inter-regional linkages and a more appropriate balance between the private and public sectors. It would also make provision for long-term technological changes, accelerated urbanization, and the rapid growth of the service industries.

The Importance of the Provincial-Municipal Sector in Policy Co-ordination

The distribution of powers by functional importance is weighted heavily in the direction of the provinces. The provincial-municipal sector accounts for close to 60 per cent of public sector expenditures in Canada, and for about 80 per cent of capital investment by all governments. Ontario accounts for 36 per cent of total provincial-municipal spending and is the source of about 42 per cent of the federal government's revenues. The growing importance of the provincial-municipal sector and the fiscal significance of the high-growth regions should be accompanied by a more important role for the provinces in overall policy formulation.

Economic Data Requirements

The economic data requirements of a co-ordinated fiscal policy extend beyond the present aggregative methods of the Tax Structure Committee.[9] An urgent need exists to develop the economic data appropriate to a federal system of regional economies, each with unique characteristics and growth problems. The elements of a co-ordinated fiscal policy become ambiguous and unreliable in the absence of sound basic economic data on gross provincial products, regional

[8]For an evaluation of post-war fiscal policy actions, see *Report of the Royal Commission on Taxation*, Ottawa, 1966, Vol. II, Chp. 3.

[9]See *The Purpose and Objectives of the Tax Structure Committee*, Op. cit.

flows-of-funds, the federal government impact in each province, and the inter-regional flows of goods and services. In particular, there is a need for:

- a clearer recognition in federal government statistical gathering operations that Canada is composed of distinct regional economies;
- official economic data showing the impact of federal fiscal and monetary operations in each regional economy;
- a more intensive effort in economic forecasting and analysis at both the national and regional levels, with ample time for all participants to study and discuss the results;
- joint consideration of anticipated monetary policy including the regional implications of changing monetary conditions and the regional aspects of flow-of-funds;
- joint consideration of private and public sector capital needs, public borrowing, debt management and cash reserve policies, and utility financing;
- breakouts of federal revenue and expenditure projections by province, so that provincial economic and fiscal planning can take federal actions into account;
- consideration of the impact of tariff and trade policies on regional economies.

Only with improved economic data of this kind can effective liaison between governments be developed.

Sectoral Stabilization Policies

According to conventional economic theory, the public sector should manipulate its revenues and expenditures to be countercyclical. For the most part, this has proven to be an unobtainable goal. Discretionary changes are still cumbersome and likely to generate pro-cyclical, or perverse economic effects.

Many of the difficulties of economic policy-making could be avoided if governments in Canada could agree to a long-run strategy to stabilize public sector growth. Such planned and co-ordinated development of the public sector over the long-run would have to be supplemented by automatic tax and social security stabilizers.

To define and stabilize the rate of growth in the public sector would require intergovernmental agreement on:

- the target share of GNP to be allocated to public sector uses over a period of years;

- a commitment to stable rates of expansion by each jurisdiction;
- an agreed long-term developmental plan with explicit priorities;
- performance targets, relating to cost and service levels in the public sector, to minimize the opportunity costs of public expenditures;
- automatic compensatory payments to the fixed and low-income persons, involving co-ordinated federal-provincial welfare systems;
- a long-range tax co-ordination program to lessen the provincial-municipal sector reliance upon regressive sales and property taxes and to increase their access to income taxes;
- timing and queuing of public sector issues in domestic capital markets.

This type of co-ordination is urgently required, for example, to encourage long-run orderly expansion of the supply of housing. The Canadian Parliamentary Standing Committee on Finance, Trade and Economic Affairs, in its fourteenth report says of the housing sector:

> In the Committee's view the housing program should be used to meet the housing needs of the country and should not be used as a device for the stimulation or otherwise of the economy.[10]

This statement accords with the Ontario Government's view that housing is a high priority sector and should be incorporated into long-term stabilization plans.

The realization of stable public sector growth would not eliminate the need for counter-cyclical measures, especially where changes in foreign conditions affect Canada's balance of payments and the exchange value of the dollar. Nor would it eliminate the volatility of private investment, consumer durable sales, farm inventories, and foreign trade. It would, however, go a long way towards effectively isolating these problems for special stabilization treatment. There still would be a need to determine priorities in the private sector and thus establish residual trade-offs against public sector programs.

Co-ordination of Tax Policies

The co-ordination of tax policies is one of the most pressing problems of Canadian federalism. The intergovernmental Tax Structure Committee was formed in 1964 for the purpose of projecting the expenditures and revenues of the public sector, and of studying the

[10]Standing Committee on Finance, Trade and Economic Affairs, *Minutes of Proceedings and Evidence*, No. 14, second session, twenty-eighth Parliament, 1969-70.

problem of fiscal balance and tax co-ordination. Its activities did not result in any major improvements in federal-provincial tax sharing. Two new ground rules have been established by the federal government since 1966. They are:

- no further increases in fiscal transfers to the provinces;
- the development of the Principle of Equal Access.

Under the first rule, the federal government argues that it cannot consider further increases in abatement of the personal income tax to the provinces because it needs to maintain a commanding majority position in the field for fiscal policy purposes. The Ontario Government has pointed out, however, that federal occupancy is far greater than that required both to meet the growth of its existing expenditure commitments and to change the total federal and provincial income taxes for fiscal policy purposes. This extra occupancy merely serves to provide the federal government with a high-growth revenue capacity to finance the continued introduction of new expenditure programs.[11]

Under the Principle of Equal Access each level of government is held responsible for raising its own revenues to finance expenditures. These two rules have prevented the development of a co-ordinated and harmonized federal-provincial tax structure in Canada. The federal white paper proposals on taxation reform would worsen the situation by pre-empting the provinces from increased use of income taxes, and by increasing the flow of fiscal resources to the federal government. If the revenues resulting from these proposals are not to be shared with the provinces, then the problem of fiscal imbalance at the provincial-municipal level will be increased and the provision of essential public services will be adversely affected. The major question in tax co-ordination for Canada is how, under a regime of independent taxation, the various governments will move to solve their financing problems without the destruction of a uniform Canadian tax structure.[12]

New approaches to this problem are necessary. There is a need for new conventions within which independent tax actions should take place. Existing intergovernmental finance discussions should be moved beyond the consideration of total revenue and expenditure projections into the following areas:

[11]See *Alternative Methods of Transferring Federal Tax Revenues to the Provinces*, Ontario Government, August, 1966: presented to the federal-provincial Continuing Committee on Economic and Fiscal Matters, Mont Gabriel, September, 1966.

[12]See *Intergovernmental Finance and Ontario's White Paper on Provincial-Municipal Reform*, Ontario Department of Treasury and Economics, Taxation and Fiscal Policy Branch: presented to federal-provincial Constitutional Committee, Ottawa, June, 1969.

- the wider interprovincial implications of particular tax changes within the total tax framework;
- the economic implications and tax-exporting properties of certain tax policies;
- insight into which taxes are best used for particular types of objectives by federal and provincial-municipal governments;
- the essential requirements for complementary and non-competitive actions.

Conclusion

The foregoing paper has reviewed some of the problems of designing and co-ordinating economic policies appropriate for Canada's diversified economy. It suggests that new initiatives are required to define national objectives and to strengthen Confederation. The paper is offered as an initial contribution by the Government of Ontario to this process.

APPENDIX

THE ECONOMIC OUTLOOK

The Importance of Monetary Policy

Despite the emphasis given to the restraining influence of fiscal policies in recent months, the most powerful depressant to economic growth at the present time is extremely tight monetary policy.

During 1967 and 1968, expansionary financial developments in both Canada and the United States contributed to the inflationary growth of the Canadian economy. However, late in 1968 monetary policy turned sharply restrictive in both countries. Towards the end of 1969, the financial environment in Canada inhibited economic growth and reinforced a marked swing into budgetary surplus by the federal government, with a massive build-up of federal cash balances. This, however, did not prevent the economy from achieving the same rate of increase in real Gross National Product in 1969 (4.8 per cent) as in 1968, although significant signs of softness appeared in the fourth quarter of 1969, especially in business capital spending, residential construction, sales of durable goods and corporate profits. GNP growth in current dollar terms was higher in 1969 (9.3 per cent) than in 1968 (8.9 per cent) due to an increased rate of inflation. By the end of the third quarter of 1969, the restrictive impact on many financial flows was apparent and the total supply of new funds in the economy was 14.2 per cent below the volume supplied in the first nine months of 1968.

The Delayed Impact of Economic Policies

The Ontario economy also displayed uneven growth in the fourth quarter of 1969, as the lagged effects of restrictive monetary and fiscal policies began to take hold. These policies are still working their way through the economy. The weakness in residential construction, the potential softness in automotive exports and the demand for consumer durables, combined with the growing sensitivity of other sectors to the reduced volume of new credit, suggest that further monetary restraint could drive the Ontario economy towards a recession.

Summary Review of 1969

The Ontario economy continued to experience vigorous growth in 1969 despite lengthy mid-year strikes in the mining, manufacturing

and construction industries. The Gross Provincial Product grew by 9.6 per cent in 1969, but 4.2 per cent of the gain was due to price increases. Real output of goods and services increased by 5.2 per cent, a moderate improvement over the 1968 increase of 4.6 per cent.

Most of the gain in output occurred in the first quarter, as a widespread buoyancy of demand gave a strong initial impetus to the economy. Although growth declined sharply in the second quarter as a result of prolonged strikes, it resumed a strong upward trend for the rest of the year. However, in the fourth quarter the impact of deflationary monetary and fiscal policies began to register and the pattern of demand became distinctly uneven. Consumer demand and exports were stronger in the fourth quarter than earlier in the year but business capital spending was weaker and residential construction expenditure declined.

Consumer Demand

Retail sales rose by $776 million to a record level of $10.6 billion, 7.7 per cent higher than in 1968. The largest gains were recorded in sales of non-durable goods, particularly by general merchandise and department stores which experienced gains of 16.1 and 11.9 per cent respectively. Among durables, furniture and appliance dealers recorded an 8.3 per cent increase in sales, but pronounced year-end weakness in automobile sales resulted in only a 4.2 per cent gain over 1968. Consumer spending on services rose by 9.5 per cent, largely as a result of price increases.

Private and Public Investment

Total private and public investment rose to $6.0 billion from $5.5 billion in 1968, an increase of 9.0 per cent.

The most pronounced gains occurred in residential construction: 81,446 units were started in 1969, an increase of 1.3 per cent. The high level of starts, together with the 60,035 units under construction at the end of 1968, resulted in the completion of 80,236 housing units, of which 48 per cent were apartment units and 39 per cent single family dwellings. The Ontario Housing Corporation was again very active in supplementing the private sector. During the course of the year, OHC recorded 5,210 starts for low income families and senior citizens, up 5.8 per cent from 4,922 starts in 1968. In total, 5,871 new units were completed in 1969, an increase of 33 per cent over those completed in 1968. Total spending on residential construction increased by 20 per cent, but there was a significant reduction in housing activity towards the end of 1969 as tight money made mortgage financing difficult and extremely expensive.

The level of capital spending by government and institutional services, for instance, schools, universities and hospitals, rose by less than one per cent and declined in real terms.

The upsurge of capital spending by the business sector, that got under way late in 1968, continued until mid-year when strikes in major industries delayed and discouraged new investment. Spending on machinery and equipment increased by 7.9 per cent and on non-residential business construction by 9.0 per cent. The areas of most rapid growth were the chemical and primary metals industries.

Foreign Demand

Commodity exports rose to a level of $6.8 billion, an increase of 14.1 per cent over 1968. The largest gain was recorded in automotive products which increased by 32 per cent. Exports of nickel ore and fabricated nickel declined by 13 per cent and those of fabricated steel products by 22 per cent. Automotive products have become an increasingly important source of export growth since the mid-sixties, and currently constitute Ontario's largest single export commodity.

Employment

Ontario's labour force increased by 98,000 persons to 3,032,000 in 1969, a gain of 3.3 per cent. Labour force growth was most pronounced in the first half of the year and the 106,000 new jobs available in 1969 more than absorbed the increase in the labour force. Consequently, the unemployment rate fell to 3.1 per cent from 3.5 per cent the year before. In the fourth quarter, however, the unemployment rate rose to 3.5 per cent as job opportunities levelled off.

Incomes

Total personal income in Ontario rose from $22.4 billion in 1968 to $24.9 billion in 1969, an increase of 11.2 per cent. Personal income per capita in the same period rose 9.0 per cent from $3,065 to $3,341. However, rising prices reduced the increase in real terms to 4.3 per cent.

Despite lengthy strikes in the nickel and steel industries, total wages and salaries in the province increased by 12.0 per cent to $15.6 billion. Wage increases were unusually large; the average hourly wage in manufacturing climbed during the year to $2.93 from $2.70, an increase of 8.5 per cent, compared to a 7.3 per cent rise in 1968.

Corporate profits in 1969 rose to an estimated $3.7 billion, a moderate increase of 5.5 per cent over 1968. They declined sharply in the last quarter of 1969 as a result of slower economic growth and

increasing costs, due in part to high wage settlements and credit restraints.

Prices

Despite fiscal and monetary restraints, rapid price increases continued to plague the economy in 1969. No sector of the economy escaped price advances. For the fifth consecutive year price increases averaged over 3.0 per cent. Housing, non-residential construction, and government expenditure experienced the most severe price increases. However, some lessening in overall price increases had become evident by the end of the year.

The Outlook for 1970

The outlook for the Ontario economy in 1970 is extremely uncertain because of the indefinite position of fiscal and monetary policies throughout the North American continent. Our projections for 1970 assume some relaxation of monetary policy, a certain level of automatic stabilization from fiscal policies, and no serious deterioration in business confidence. If these assumptions prove correct, Canada and Ontario will emerge from the present period of restraint with an undiminished capacity for recovery.

Gross Provincial Product in 1970 is expected to rise to a level of $34.6 billion, an increase of 7.0 per cent. It is anticipated the rise in volume terms will be about 3.0 per cent and that prices will rise by 3.9 per cent. However, slower growth of new job opportunities relative to the growth of the labour force is expected to increase the unemployment rate from 3.1 per cent in 1969 to 4.1 per cent. Personal spending on non-durables and business capital investment is expected to provide the greatest stimulus to the economy in 1970.

In its budget of March 12, 1970, the federal government adopted a cautiously optimistic view for economic performance in 1970. The reduction in the surplus on a national accounts basis from $570 million in 1969-70 to $130 million in 1970-71 will provide a small expansionary push to the economy. However, on balance, the combined fiscal and monetary effects of federal policies are still restrictive. With high levels of cash balances and foreign exchange reserves, Ottawa is in a reasonably strong position to switch to less restraint in fiscal and monetary policies in the near future.

The outlook for 1970 will be determined by the course of inflation and subsequent adjustments to fiscal and monetary policy, which cannot be estimated with certainty at this time. Therefore the projections which follow are based on estimates of the most likely environmental conditions throughout 1970.

THE ONTARIO ECONOMY[1]
1968-70

	1968	1969[2]	1970[2]	68/67	69/68	70/69
	($ billion)			(% changes)		
Gross provincial product	29.5	32.3	34.6	8.8	9.6	7.0
GPP (constant 1961 dollars)	24.0	25.2	26.0	4.6	5.2	3.0
Prices (1961=100)	123.1	128.3	133.3	4.0	4.2	3.9
Private and public investment	5.5	6.1	6.7	4.9	9.0	10.0
Public	1.3	1.3	1.4	7.4	1.0	5.0
Private	4.2	4.7	5.3	4.2	11.5	12.6
Machinery and equipment	1.9	2.1	2.4	—0.7	7.9	13.3
Construction	2.3	2.6	2.9	8.7	14.5	12.0
Non-residential	1.1	1.2	1.5	—2.5	9.0	23.0
Residential	1.1	1.4	1.4	22.8	20.0	2.0
Retail sales	9.8	10.6	11.3	9.7	7.7	6.7
Imports (Canada)	12.4	14.2	15.6	13.6	14.9	10.0
Exports (Canada)	13.6	14.9	15.6	19.1	9.3	5.0
Exports (Ontario)	6.0	6.8	7.2	28.3	14.1	5.0
Wages and salaries	13.9	15.6	16.9	9.3	12.0	8.5
Corporate profits	3.5	3.7	3.7	9.8	5.5	0.0
Personal income	22.4	24.9	26.8	10.2	11.2	7.6
Labour force (000's)	2,934	3,032	3,124	3.5	3.3	3.0
Employment (000's)	2,830	2,936	2,996	3.1	3.7	2.0
Unemployment (% of labour force)	3.5	3.1	4.1	—	—	—
Productivity	—	—	—	1.5	1.4	1.0
Personal income per capita	$3,065	$3,341	$3,504	7.9	9.0	6.0
Housing starts (units)	80,375	81,446	80,000	18.0	1.3	—1.8

[1]Gross Provincial Product estimates based upon revised Gross National Product estimates for Canada.

[2]Estimated Department of Treasury and Economics.

Budget Paper B

The Structure of Public Finance in Ontario

TABLE OF CONTENTS

THE STRUCTURE OF PUBLIC FINANCE IN ONTARIO

This paper brings together in a comprehensive framework the fiscal operations of the total government sector in Ontario. It quantifies the amount of revenues raised and spent by each level of government and shows the significant financial interactions among them. In particular, it is intended to place the federal government's role in the province in perspective and to provide insight into the overall fiscal impact of government on the Ontario economy.

Section I of the paper examines the operations and financing of the total government sector within Ontario in 1968-69. It reveals that the federal government drew off $1.4 billion from Ontario, largely for redistribution to the fiscally weaker provinces. At the same time, the provincial-municipal level of government incurred substantial deficits, a reflection of their chronic underfinancing.

Section II of the paper focuses on the role of the federal government as a redistributor of fiscal resources among the provinces. It discusses the major ways in which financial resources flow from Ontario and other prosperous provinces to the fiscally weaker provinces. Finally, it indicates some of the drawbacks of implicit equalization in interprovincial redistribution.

Continuing analysis of this kind is essential to an improved understanding of the redistributive role of the federal government and the regional economic impact of federal policies. Furthermore, it is a fundamental prerequisite to the development of an improved intergovernmental machinery for fiscal policy co-ordination in Canada.

I THE TOTAL GOVERNMENT SECTOR IN ONTARIO

The Federal Government in Ontario

Revenue. In 1968-69, the federal government raised $5,265 million in revenue in Ontario, or a total of $721 per capita. This amounted to 24 per cent of total personal income in the province or 18 per cent of Gross Provincial Product. The most important source of revenue was the dynamic personal income tax. It produced about $1,675 million[1] plus $400 million for the associated old age security tax, a total of over $2 billion. The predominance of this tax field provides the federal government with significant elasticity for its total

[1]This amount includes three months' revenue from the 2 per cent social development tax, effective January 1, 1969.

revenue. The corporation income tax was the next most important source at almost $1 billion, including the earmarked old age security portion. The federal manufacturers' sales tax and other excise taxes yielded about $815 million.[2] Further details on federal revenue are shown in a comprehensive table on total government revenue in Ontario (see Table 6).

Expenditure. Total federal expenditure in Ontario during the 1968-69 fiscal year is estimated at $3,865 million, or $529 per capita. Relatively little functional detail is available on this expenditure.[3] Transfers to provincial and local governments amounted to $647 million. Interest payments on the public debt are estimated at $500 million and old age security payments at $553 million. Payments to persons are a large part of other expenditure, with the remainder being spent on goods and services.

The Federal Surplus in Ontario. Federal revenue and expenditure resulted in a surplus in Ontario of $1.4 billion, almost $200 per capita. This is well in excess of the total yield of the municipal property tax, and almost as much as total operating and capital spending by all local school authorities in Ontario.

It is significant that, while running a surplus in Ontario, the federal government ran a deficit in Canada as a whole in 1968-69. Even in a deficit year the federal government withdrew a large amount of purchasing power from Ontario, the equivalent of 6.25 per cent of total personal income.

	Ontario	Canada
	($ million)	($ million)
Total Federal Revenue	5,265	12,680
Total Federal Expenditure	3,865	12,747
Surplus or (Deficit)[4]	1,400	(67)

The federal surplus in Ontario is important in two major respects. First, along with the smaller federal surpluses in Alberta and British Columbia, it finances federal aid to other provinces in the form

[2]Old Age Security Tax Revenue ($ million)

Personal income tax	400
Corporation income tax	80
Sales tax	200
	680

[3]In answer to a question by Mr. Balcer in 1964, the then federal Minister of Finance provided a breakdown by province of federal revenue and expenditure. However, no functional detail was given. See Reply of the Minister of Finance to Question No. 741 by Mr. Balcer made order for return Wednesday, July 22, 1964.

[4]On a National Accounts basis.

of equalization grants, shared-cost programs, regional development schemes, and direct transfers to individuals. The extent and form of interprovincial transfers by the federal government are examined in more detail in Section II. Second, the federal surplus in Ontario is important as a measure of the strong deflationary influence exerted on the Ontario economy by the federal government.

Expenditure restraints, combined with increased taxation and buoyant revenues, are estimated to have changed the federal national deficit into a surplus of almost $600 million in 1969-70.[5] This dramatic fiscal shift may have resulted in a surplus in Ontario of over $1,850 million, or 7.4 per cent of estimated personal income, compared to 6.25 per cent the year before. This estimate of "fiscal drag" may be conservative in view of the strong performance of the Ontario economy compared to the rest of Canada.

These results illustrate clearly that the federal fiscal presence in Ontario tends to compensate automatically for inter-regional differences in incomes and economic activity, thereby acting as an important stabilization force in the national economy. The significance of this factor in the design of federal fiscal policy and federal-provincial policy co-ordination has been described in Budget Paper A.

The Provincial Government in Ontario

Revenue. Total provincial government revenue in 1968-69 amounted to $3,465 million.[6] The Ontario Government raised $2,862 million from provincial sources and received $603 million from the federal government in the form of conditional and unconditional grants. Total collections by the Ontario Government were $392 per capita, or 13 per cent of total personal income.

The personal income tax accounted for only 18 per cent of gross provincial revenue, commodity taxes for 22 per cent, gasoline, fuel taxes and other motor vehicle revenues for 14 per cent, and corporation taxes for 10 per cent. As a result, the growth potential of provincial government revenue is much smaller than that of the federal government, whose revenue is dominated by the more elastic personal income tax. (See Table 6.)

Federal unconditional grants to the Ontario Government consist primarily of the cost adjustment payments for post-secondary education operating expenditure. In 1968-69, these payments of about $127 million included $35 million relating to the previous fiscal year.

[5]On a National Accounts basis.
[6]Table F in the Appendix contains a reconciliation with the Ontario Government's budget and Public Accounts.

Federal conditional grants of $476 million to the Ontario Government were dominated by federal participation in hospital insurance ($285 million) and the Canada Assistance Plan ($120 million).[7]

Table 1

Provincial Government Revenue 1968-69

	$ Million	$ Per Capita	% Distribution
Provincial Collections	2,862	391.70	82.6
Federal Unconditional Grants	127	17.40	3.7
Federal Conditional Grants	476	65.20	13.7
Total Gross Revenue	3,465	474.30	100.0

Expenditure. Total gross expenditure by the provincial government in 1968-69 amounted to $3,606 million, or $494 per capita. On a gross basis, and including all transfers to local government authorities, 31 per cent of total spending was on education, with health accounting for another 27 per cent. Health and education combined thus accounted for 58 per cent of total expenditure.

The most significant aspect of provincial government spending, however, is the magnitude of support to local government authorities. They received $1,183 million from the provincial government, almost one-third of gross provincial spending. Other provincial government

Table 2

Provincial Government Expenditure 1968-69

($ million)

	Total Gross Expenditure	Transfers to Local Authorities	Provincial Direct Spending
Education	1,106	685	421
Health	957	16	941
Transportation	445	169	276
Welfare	254	112	142
Debt Charges	196	—	196
Unconditional Transfers	166	166	—
Natural Resources	136	12	124
Protection	97	8	89
All Other	249	15	234
Total	3,606	1,183	2,423

[7]Further details on federal grants are shown in the Appendix, Table A.

direct spending amounted to $2,423 million. Transfers to local governments have been recognized separately and are counted as ultimate expenditure by local governments.

Summary of Provincial Government Transactions. The combined revenue and expenditure position for 1968-69 resulted in a deficit of $141 million. Debt retirements of $74 million brought the cash deficiency to a total of $215 million, before allowing for provincial borrowing and lending operations in the non-budgetary account. This account includes both borrowing from the Canada Pension Plan ($412 million) and a number of superannuation funds and, lending to universities ($173 million), school boards ($180 million), hospitals ($27 million), and the Ontario Hydro nuclear power generating station ($19 million). Provincial lending enabled universities and school boards to meet the large requirements for new facilities at considerable savings in cost, and without the problems associated with borrowing in the capital market.

Table 3

Summary of Provincial Budgetary Transactions 1968-69*

	$ Million	$ Per Capita
Gross Budgetary Revenue	3,465	474.30
Gross Budgetary Expenditure	3,606	493.60
Deficit	(141)	(19.30)

*For reconciliations with published data, see Appendix, Table F.

Local Government Authorities in Ontario

Revenue. An analysis of local government revenue shows dramatically the inadequacy of the property tax in financing municipal and school board expenditure. In per capita terms, the property tax in Ontario is already the highest in the country, yet it accounted for only 46.5 per cent of total local revenue in 1968-69. An additional 4.6 per cent was raised from other local revenue sources. The remaining 48.9 per cent of local revenue came primarily from provincial government grants.[8] (See Table 6.)

Expenditure. Local government operating and capital expenditure totalled $2,768 million in 1968-69, or $378 per capita. More than 50 per cent of this is accounted for by the school authorities.

[8]Further details on provincial grants are provided in the Appendix, Table B.

Table 4

Total Local Government Revenue 1968-69

	$ Million	$ Per Capita	% Distribution
Municipal Sources			
Property Tax	1,169	160.00	46.5
Other Revenue	115	15.75	4.6
Provincial Transfers			
Unconditional Transfers	166	22.75	6.6
Conditional Transfers	338	46.30	13.5
Operating Grants to School Boards	566	77.50	22.5
Capital Grants to School Boards	58	7.90	2.3
Contribution to Teachers' Superannuation Fund*	55	7.70	2.2
Federal Transfers			
Payments In Lieu of Taxes, etc.	44	6.00	1.8
Total Gross Revenue	2,511	343.70	100.0

*The provincial government makes direct contributions to this Fund on behalf of local authorities.

Table 5

Total Local Government Expenditure 1968-69*

	$ Million	$ Per Capita	% Distribution
Education	1,488	203.70	53.8
Transportation and other Public Works	397	54.35	14.3
Protection	202	27.65	7.3
Health and Sanitation	190	26.00	6.9
Social and Economic Welfare	165	22.60	6.0
General Government	109	14.90	3.9
All Other Municipal Activities	217	29.70	7.8
Total	2,768	378.90	100.0

*Interest payments on debt are not shown separately but are included in the function to which they are related.

Summary of Local Government Transactions. The revenue and expenditure operations of local government generated a deficit of $257 million, a large proportion being accounted for by school authorities. In addition, debt retirements of $137 million had to be financed.

Of the resulting overall financing requirement of $394 million, approximately $180 million was made available through the Ontario Education Capital Aid Corporation.

The Total Government Sector in Ontario

The total government sector had a significant economic impact on Ontario because of the size of its net financial drain from the provincial economy.[9] Total revenues collected in the Province by all governments in 1968-69 exceeded $9.4 billion, 42 per cent of total personal income, or 32 per cent of Gross Provincial Product. In comparison, total government spending was about $8.4 billion, leaving an overall surplus of $1 billion. As already shown, the federal government diverted a $1.4 billion surplus to uses outside the province. Provincial and local governments offset this in part with a deficit of $400 million.

Revenue. Table 6 provides an overview of the major revenue sources for the three levels of government in Ontario. It shows the federal government's predominant share of total government revenue and the degree to which each level of government depends on particular types of taxes, as well as other revenue sources.

Table 6

Total Government Revenue Collections in Ontario 1968-69

($ million)

	Federal	Provincial	Local	Total
Personal Income Tax	1,675	620	—	2,295
Commodity Taxes	615	763	—	1,378
Corporation Taxes	905	354	—	1,259
Local Property Tax	—	—	1,169	1,169
Old Age Security Taxes	680	—	—	680
Gasoline and Other Motor Vehicle Taxes & Levies	—	496	—	496
Investment Income	330	124	—	454
Other Duties and Taxes	310	34	—	344
Customs Duties	305	—	—	305
Hospital Insurance Premiums	—	270	—	270
Non-tax Revenue	—	111	115	226
Unemployment Insurance	175	—	—	175
Government Pension Fund	170	—	—	170
Estate Tax and Succession Duties	45	90	—	135
Non-resident Taxes	80	—	—	80
Miscellaneous Adjustments	–25	—	—	–25
Total	5,265	2,862	1,284	9,411
Percentage Distribution	56.0	30.4	13.6	100.0

[9]This excludes the Canada Pension Plan and such non-budgetary operations as the Central Mortgage and Housing Corporation.

The personal income tax is very important to the growth potential of total government revenue, because of its comparatively high elasticity. Dominance in this field gives the federal government a great advantage over other governments. The federal government retains 73 per cent of the total income tax raised in Ontario,[10] which accounts for 32 per cent of the total federal revenues obtained in the province.[11] In contrast, the provincial-local governments receive only the remaining 27 per cent of the income tax yield, which is equal to 15 per cent of their combined revenue.

Table 6 shows the great dependence of local government on the inelastic property tax. The provincial government has reasonably diverse revenue sources, although with a growth potential which is very inferior to that of the personal income tax. Altogether, provincial and local governments raise only 44 per cent of total government revenue collected in Ontario.

Expenditure. In this paper, government expenditure has been determined according to the level of government where the ultimate spending occurred. For example, grants from the federal government for hospital insurance show up as provincial spending, and provincial grants show up as spending by local governments. As a result, the distribution of spending among the three levels of government is markedly different from the distribution of revenue collections.

Table 7 contains a comprehensive picture of total government spending, identified as far as possible by function. It illustrates the importance of education and health at the provincial-municipal level, and of social security and welfare at the federal level. Welfare and social security spending by the federal government is dominated by old age security and family allowance payments.

The financial pressures at the provincial-local level of government are the direct result of the fact that education and health, both rapidly growing functions, account for almost 60 per cent of total spending. Provincial and local governments cannot finance this growth without increasing taxes.

Intergovernmental transfer payments have played a critical role in bringing the provincial-local government sector closer to financial balance. In the absence of all transfer payments the federal government would have run a surplus of over $2 billion in 1968-69 and the Province would have run a surplus of over $400 million, while local

[10] The basic abatement relationship of 72 and 28 is distorted primarily by the federal social development tax.

[11] The percentage contribution of personal income tax revenue in total federal revenue is estimated to rise to 36 per cent in 1970-71. See federal *Budget Speech*, Department of Finance, Ottawa, March 12, 1970.

Table 7

Total Government Expenditure in Ontario 1968-69
($ million)

	Federal	Provincial	Local	Total
Education	—	421	1,488	1,909
Health	—	941	190	1,131
Social Security & Welfare	960	142	165	1,267
Debt Charges	500	196	—[1]	696
Transportation and other Local Public Works	—	276	397	673
Protection	—	89	202	291
Natural Resources	—	124	—	124
All Other	1,758[2]	234	326	2,318
Total	3,218	2,423	2,768	8,409
Percentage Distribution	38.3	28.8	32.9	100.0

[1]Distributed over other functions.
[2]Includes expenditure on some specified functions, but details not available.

governments would have been in deficit by $1.5 billion. After all intergovernmental transfers, the federal government was left with a surplus of $1.4 billion, the Province was in deficit by $141 million and the local government deficit had been reduced to $257 million. Table 8 illustrates the financial positions of the three levels of government in 1968-69 before and after intergovernmental transfers.

Table 8

Total Government Revenue and Expenditure in Ontario 1968-69
($ million)

	Revenue Before Transfers	Total Expenditure	Surplus or (Deficit)	Net Transfers	Final Surplus or (Deficit)
Federal Government	5,265	3,218	2,047	(647)	1,400
Provincial Government	2,862	2,423	439	(580)	(141)
Local Government	1,284	2,768	(1,484)	1,227	(257)
Total Government Sector	9,411	8,409	1,002		1,002

Summary

The foregoing analysis shows the major dimensions of total government activity in Ontario, and indicates the financial interaction of the three levels of government. The chart at the conclusion of this

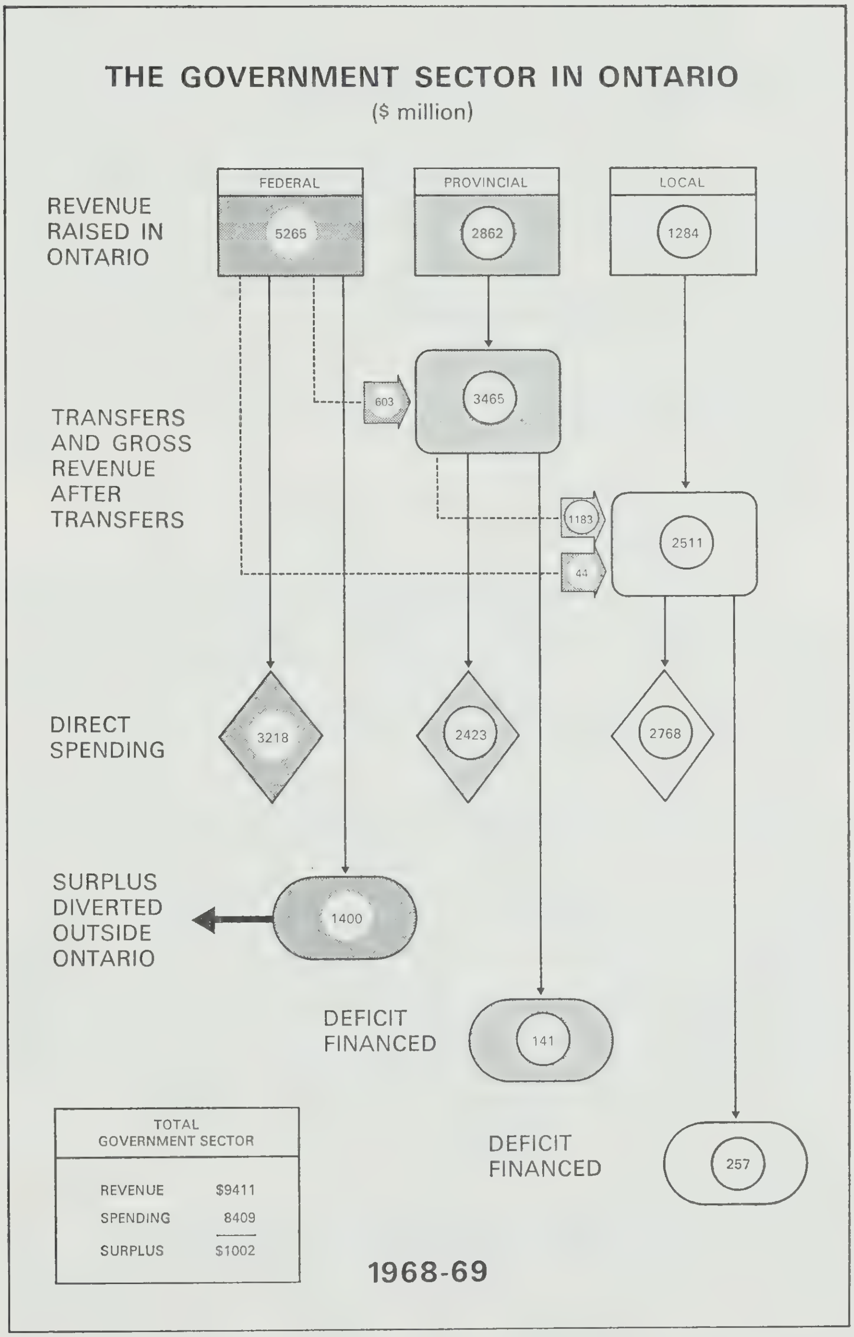
section portrays these fiscal interactions. Four major conclusions can be drawn from this study of total government operations in Ontario.

1. The federal government accounts for only 38 per cent of total spending compared to 56 per cent of total revenue raised in Ontario. Provincial and local governments account for 62 per cent of total spending while raising only 44 per cent of total government revenue.

2. In 1968-69, the federal government ran a surplus of $1.4 billion in Ontario and the provincial-municipal sector incurred a deficit of $400 million. The federal government's surpluses are directly related to its redistributive function among the provinces and, as emphasized in Budget Paper A, the size of these surpluses needs to be identified for the purpose of federal-provincial fiscal planning.

3. The federal financial position in Ontario exerts a permanent "fiscal drag" or deflationary impact on the Ontario economy. It is interesting to show how, in the context of recent economic conditions, the total public sector has performed to contain inflationary pressures. In 1969-70, the federal surplus in Ontario increased sharply as the federal government moved into an overall surplus position in Canada. At the same time the Ontario Government successfully achieved a surplus budget, while local governments curtailed their borrowing under restrictive capital market conditions. Therefore, the combined impact of all governments in Ontario was one of massive fiscal restraint, working powerfully to contain inflation.

4. The existing distribution of revenue sources, even after intergovernmental transfers, is seriously out of balance. The provincial and local governments are underfinanced. The bulk of their spending is on functions whose natural growth far outstrips the potential of current revenue sources. This situation leads to chronic pressures for increased taxes and borrowing.


THE GOVERNMENT SECTOR IN ONTARIO
($ million)
FEDERAL
PROVINCIAL
LOCAL
REVENUE RAISED IN ONTARIO
5265
2862
1284
TRANSFERS AND GROSS REVENUE AFTER TRANSFERS
603
3465
1183
44
2511
DIRECT SPENDING
3218
2423
2768
SURPLUS DIVERTED OUTSIDE ONTARIO
1400
DEFICIT FINANCED
141
DEFICIT FINANCED
257
TOTAL GOVERNMENT SECTOR
REVENUE $9411
SPENDING 8409
SURPLUS $1002
1968-69

II THE FEDERAL ROLE IN INTERPROVINCIAL EQUALIZATION

Although this paper is primarily concerned with the total government sector in Ontario, the size of the federal surplus in Ontario emphasizes the importance of the federal redistributive role in Canada.

There are four main ways in which the federal government utilizes the funds it transfers out of Ontario:

- revenue equalization payments
- special Atlantic Provinces Grants
- direct spending policies
- implicit equalization through cost sharing.

The operation of explicit equalization payments is fairly straightforward and well documented.[12] In 1968-69, these payments amounted to about $566 million. The only provinces not receiving equalization payments were Ontario, British Columbia and Alberta. The special grants to the Atlantic Provinces are included in the above total.

Federal spending policies do not lend themselves to comprehensive analysis because of the absence of regional details, although many examples could be cited. For instance, the federal Fund for Rural Economic Development (FRED) and the 1965 Agricultural and Rural Development Act (ARDA) were oriented toward Prince Edward Island, New Brunswick, Manitoba and Quebec. The new Department of Regional Economic Expansion operates an extensive grant program geared to the less developed regions of eastern Canada. Similarly, departments such as Agriculture, and Fisheries and Forestry are strongly oriented toward particular regions in the country.

Implicit Equalization

Implicit equalization merits special attention in this paper. This form of redistribution is the result of the formulas used in the financ-

[12]For an elaborate explanation of revenue equalization grants, see D. H. Clark, *Fiscal Need and Revenue Equalization Grants*, Canadian Tax Foundation and Institute of Intergovernmental Relations, September, 1969.

ing of certain federal-provincial shared-cost programs. When a formula stipulates fixed per capita grants, or grants based on national average per capita cost, the federal government contributes widely varying proportions of actual program cost in the different provinces. The three significant programs where this form of redistribution occurs are hospital insurance, medicare and post-secondary education.

Hospital Insurance. The sharing formula for this program is based on both actual per capita cost in each province and national average per capita cost. This mixed formula maintains the degree of redistribution at modest levels. Table 9 illustrates the results of the formula for the various provinces. Obviously, these results are out of tune with the revenue equalization payments. Quebec, a major recipient of equalization payments, is slightly undercompensated, while British Columbia is paid in excess of 50 per cent of actual cost.

Medicare. The sharing formula for the medicare program is based on national average per capita cost of the participating provinces. Also, per capita costs in individual provinces differ more widely than in hospital insurance. The resulting distribution pattern is similar to that for explicit revenue equalization payments. Ontario and British Columbia are significantly undercompensated, while the Atlantic Provinces receive payments markedly in excess of the norm. As an illustration of the capricious incidence of the formula, Saskatchewan receives almost 70 per cent of its total cost, while Manitoba receives less than half. Table 10 shows these relationships, based on estimated costs for medicare in all provinces in 1970-71.

Post-Secondary Education. The sharing formula for this program is based on 50 per cent of actual cost or $15 per capita, escalated at the growth rate of national spending in this area. Each province has selected the option that is to its greatest advantage. In practice this works out in such a way that the high-cost provinces, notably Ontario and Alberta, receive 50 per cent of their operating expenditure on post-secondary education. However, the escalated $15 option again is a potential medium for significant redistribution. Table 11 illustrates that Newfoundland, New Brunswick and Prince Edward Island are implicitly overcompensated under this program. According to the recent Tax Structure Committee projections, this overcompensation will become more pronounced over a number of years. For instance, by 1970-71 Newfoundland would receive more than 100 per cent of its operating expenditure in post-secondary education from the federal government.

Table 9

Distributional Implications of Hospital Insurance Program 1968-69*

	Federal Grants as Per Cent of Program Cost	Implicit Redistribution	
		Under-payment	Over-payment
	(%)	($ thousand)	
Newfoundland	56.4	—	1,971
Prince Edward Island	65.4	—	787
Nova Scotia	54.0	—	1,951
New Brunswick	51.8	—	786
Quebec	49.5	2,421	—
Ontario	48.4	9,297	—
Manitoba	52.5	—	1,689
Saskatchewan	51.2	—	829
Alberta	50.1	—	153
British Columbia	52.6	—	3,552
Canada	50.0	11,718	11,718

*For details, see Appendix, Table C.

Table 10

Distributional Implications of Medicare 1970-71*

	Federal Grants as Per Cent of Program Cost	Implicit Redistribution	
		Under-payment	Over-payment
	(%)	($ thousand)	
Newfoundland	103.7	—	6,709
Prince Edward Island	93.8	—	1,288
Nova Scotia	61.8	—	3,624
New Brunswick	67.0	—	3,948
Quebec	53.2	—	9,082
Ontario	43.9	26,217	—
Manitoba	47.8	1,149	—
Saskatchewan	69.6	—	6,732
Alberta	53.7	—	2,680
British Columbia	44.4	6,697	—
Canada	50.0	34,063	34,063

*For details, see Appendix, Table D.

Table 11

Distributional Implications of Post-Secondary Education Program 1968-69*

	Federal Transfers as Per Cent of Total Cost	Implicit Overpayment
	(%)	($ thousand)
Newfoundland	84.2	3,818
Prince Edward Island	66.5	511
Nova Scotia	50.0	—
New Brunswick	60.0	1,894
Quebec	50.0	—
Ontario	50.0	—
Manitoba	50.0	—
Saskatchewan	50.0	—
Alberta	50.0	—
British Columbia	50.0	—
Canada	51.0	6,223

*For details, see Appendix, Table E.

The foregoing examples of implicit equalization serve to illustrate the weakness of many shared-cost programs.[13] The redistribution element in these programs greatly reduces the need for additional tax effort in the "have-not" provinces, while the "have" provinces must resort to a significant tax effort to secure the same social benefits. These shared-cost formulas also appear to penalize those provinces that are most advanced in hospital technology and medical innovation, the benefits of which are available to all Canadians.

Revenue equalization payments were developed to offset fiscal disparities among provinces, whereas the basic objective of shared-cost programs is the provision of national minimum standards of service. The present shared-cost formulas ignore the fact that there are cost differences among provinces in providing a uniform standard of service. Consequently, a given amount of federal assistance finances more real services in some provinces than in others. Also, rapid growth provinces, such as British Columbia, Ontario and Alberta, are faced with demands on the public sector for expensive social capital that is not required in the other provinces.

[13]See also George E. Carter, *Canadian Conditional Grants Postwar*, (unpublished doctoral thesis, Clark University) November, 1969; p. 124.

Table 12

Provincial-Municipal Revenue Before and After Federal Transfers 1968-69

($ per capita)

	Revenue From Own Sources	Unconditional Transfers[1]	Conditional Transfers[2]	Total Revenue Including Transfers	Transfers as Per Cent of Total Revenue
					(%)
Newfoundland	235	169	128	532	55.8
Prince Edward Island	241	147	108	495	51.5
Nova Scotia	283	135	100	518	45.4
New Brunswick	278	133	106	516	46.3
Quebec	457	89	77	623	26.6
Ontario	546	16	65	627	13.2
Manitoba	446	57	80	582	23.5
Saskatchewan	510	42	76	628	18.8
Alberta	574	23	75	672	14.6
British Columbia	545	11	72	629	13.2

[1]Primarily Revenue Equalization Payments and Post-Secondary Education Adjustment Payments.

[2]Primarily Shared-Cost Programs (Hospital Insurance, Canada Assistance Plan, Technical and Vocational Training, Trans-Canada Highway, Atlantic Development Board, ARDA).

Summary

Federal financial transfers have played a key role in minimizing fiscal disparities among the different provinces. Table 12 illustrates the substantial redistribution of financial resources that occurred within our federal system in 1968-69.

Subsequently, all provinces have indicated that they will participate in national medicare and the federal government has embarked on a large-scale program of regional economic expansion. Such recent developments will increase the dimensions and strengthen the pattern of fiscal redistribution within Canada. Indeed, Canada has possibly gone further toward inter-regional equalization than any other western country.

APPENDIX

Table A

Federal Grants to Provincial-Municipal Governments in Ontario 1968-69

($ million)

Unconditional		
Post-Secondary Education Adjustment Payment	117.3	
Statutory Subsidy	4.6	
Share of Tax on Public Utilities	5.5	
Payments In Lieu of Taxes	25.3	
Other to Municipalities	1.3	
		154.0
Conditional		
Hospital Insurance Plan	284.7	
Hospital Construction	7.0	
Other Health	28.0	
Canada Assistance Plan	120.0	
Other Welfare	9.2	
Technical and Vocational Training	12.3	
Resource Development	1.4	
Regional Development	5.6	
Transportation	3.1	
All Other	4.4	
Total to Provincial Government		475.7
Total to Municipalities		17.3
Grand Total to Provincial and Local Governments		647.0

Table B

Summary of Provincial Grants to Local Authorities in Ontario 1968-69

($ million)

Unconditional		
Residential Property Tax Reduction	110.0	
Per Capita Grants	42.1	
Mining Municipalities	8.7	
Grants In Lieu of Taxes	3.1	
Other	2.1	
		166.0
Conditional		
School Board Assistance	566.3	
Vocational Schools	57.7	
Teachers' Superannuation	54.9	
Transportation and Communication	168.8	
Social and Economic Welfare	111.5	
Health	15.8	
Recreation, Home and Community Environment	14.2	
Conservation	11.8	
Public Safety	8.3	
Other	7.6	
		1,016.9
Total Provincial Grants		1,182.9

Table C

Distributional Implications of Hospital Insurance 1968-69

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	Implicit Redistribution	
	Eligible Population	Total Cost Per Capita	Total Cost	25% of National Average Per Capita Cost	25% of Actual Provincial Cost	Federal Reimbursement (Cols. 4 + 5)	Federal Grants as Per Cent of Provincial Cost	Under-Payment	Over-Payment
	('000)	($)	($000)	($000)	($000)	($000)	(%)	($000)	($000)
Newfoundland	506	60.72	30,725	9,653	7,681	17,334	56.4	—	1,971
Prince Edward Island	108	47.16	5,094	2,060	1,274	3,334	65.4	—	787
Nova Scotia	742	65.79	48,821	14,156	12,205	26,361	54.0	—	1,951
New Brunswick	617	71.22	43,940	11,771	10,985	22,756	51.8	—	786
Quebec	5,914	77.95	460,981	112,825	115,245	228,070	49.5	2,421	—
Ontario	7,267	81.42	591,735	138,636	147,934	286,570	48.4	9,297	—
Manitoba	961	69.28	66,582	18,334	16,646	34,980	52.5	—	1,689
Saskatchewan	956	72.84	69,634	18,238	17,408	35,646	51.2	—	829
Alberta	1,516	75.91	115,074	28,921	28,769	57,690	50.1	—	153
British Columbia	1,994	69.18	137,953	38,041	34,488	72,529	52.6	—	3,552
Canada	20,581	76.31	1,570,539	392,635	392,635	785,270	50.0	11,718	11,718

Source: Department of National Health and Welfare, 1969.

Table D

Distributional Implications of Medicare 1970-71

	Population 1970-71 TSC	Per Capita Cost	Source[1]	Total Cost	50% of Total Cost	Federal Grant Based on 50% of National Average Per Capita Cost	Federal Grant as Per Cent of Total Cost	Implicit Redistribution: Under-payment	Implicit Redistribution: Over-payment
	('000)	($)		($000)	($000)	($000)	(%)	($000)	($000)
Newfoundland	521	23.96	TSC	12,483	6,242	12,951	103.7	—	6,709
Prince Edward Island	111	26.51	NHW	2,942	1,471	2,759	93.8	—	1,288
Nova Scotia	765	40.24	NHW	30,784	15,392	19,016	61.8	—	3,624
New Brunswick	627	37.12	NHW	23,274	11,637	15,585	67.0	—	3,948
Quebec	6,046	46.71	TSC[2]	282,408	141,204	150,286	53.2	—	9,082
Ontario	7,615	56.60	TSC[3]	431,009	215,504	189,287	43.9	26,217	—
Manitoba	988	52.04	TSC	51,416	25,708	24,559	47.8	1,149	—
Saskatchewan	960	35.69	TSC	34,262	17,131	23,863	69.6	—	6,732
Alberta	1,556	46.27	TSC	71,996	35,998	38,678	53.7	—	2,680
British Columbia	2,131	56.00	T&E	119,336	59,668	52,971	44.4	6,697	—
Canada	21,320	49.71		1,059,910	529,955	529,955	50.0	34,063	34,063

[1] TSC: Tax Structure Committee
NHW: Department of National Health and Welfare
T&E: Ontario Department of Treasury and Economics

[2] 1971-72 TSC projections deflated by 8 per cent

[3] TSC projection reduced by $28 million for administration and increased by $16 million for salaried physicians.

Table E

Distributional Implications of Post-Secondary Fiscal Transfers
1968-69
($ thousand)

	Total Costs	Total Federal Payment	50% of Actual Cost	Federal Payment as Per Cent of Total Costs	Implicit Overpayment
				(%)	
Newfoundland	11,160	9,398	5,580	84.2	3,818
Prince Edward Island	3,077	2,049	1,538	66.5	511
Nova Scotia	39,346	19,673	19,673	50.0	—
New Brunswick	19,480	11,634	9,740	60.0	1,894
Quebec	266,100	133,050	133,050	50.0	—
Ontario	391,400	195,700	195,700	50.0	—
Manitoba	43,905	21,953	21,953	50.0	—
Saskatchewan	42,708	21,354	21,354	50.0	—
Alberta	91,967	45,984	45,983	50.0	—
British Columbia	82,931	41,466	41,466	50.0	—
Canada	992,074	502,261	496,037	51.0	6,223

Source: Tax Structure Committee and federal Department of Finance.

Table F

Reconciliation of Ontario Government Data 1968-69

($ million)

Revenue	
Net General Revenue per Public Accounts	2,595
Add: Interest Earnings	124
Hospital Insurance Premiums	270
	2,989
Deduct: Federal Unconditional Grants	127
Provincial Collections (Table 1, Budget Paper B)	2,862
Expenditure	
Net General Expenditure per Public Accounts	2,736
Add: Interest Earnings (netted out in Public Accounts)	124
Hospital Insurance Premiums	270
Federal Conditional Grants	476
Gross Provincial Expenditure (Table 2, Budget Paper B)	3,606

Budget Paper B

The Reform of Taxation and Government Structure in Ontario

TABLE OF CONTENTS

INTRODUCTION

The Government of Ontario is convinced that fundamental fiscal and structural reforms are necessary and urgent in this province. Both the Ontario Committee on Taxation and the Select Committee on Taxation proposed extensive reforms.[1] After examining the reports of these committees and studying thoroughly their recommendations, this Government is now prepared to present its own views in this Budget Paper. In brief, this paper sets out the Government's reform objectives and its long-run plan for achieving those objectives. The plan calls for complementary and concurrent reforms on four fronts: reform of the provincial tax system, reform of provincial aid to local governments, reform of local taxation, and reform of local government structure.

I. REFORM OF THE PROVINCIAL TAX SYSTEM

The Government of Ontario is planning a major redesign and reform of the provincial tax system. This is necessary because the present system is demonstrably deficient in terms of its equity, efficiency, and capacity to raise necessary provincial funds in the years ahead. The program of provincial tax reform will seek to achieve three broad objectives:

- to establish a fairer, more balanced and more revenue-productive system of provincial taxation;
- to connect, in a coordinated manner, the provincial and municipal tax systems to allow control over the level and distribution of overall tax burdens;
- to harmonize and rationalize provincial and federal taxation in Ontario to the maximum extent possible.

The reform plan, which is set out in this Budget Paper, calls for extensive changes in existing provincial taxes. Some of these changes have already been implemented in this budget; others will be brought into effect over a number of years. The plan also suggests trade-offs between the Province and Ottawa in the shared-tax fields. Realization of the intended realignments in the shared-tax fields will depend, of course, on positive reception and reaction by the federal government. The key element in the reform plan, however, is the establishment of a personal

[1]See *Report of the Ontario Committee on Taxation* (Toronto: Queen's Printer, 1967), commonly referred to as the Smith Committee and *The Report of the Select Committee of the Legislature on the Report of the Ontario Committee on Taxation* (Toronto: Government of Ontario, 1968), commonly referred to as the Select Committee.

income tax system for Ontario. This fundamental departure from the present character of provincial taxation is the core around which Ontario's new tax system will be developed.

1. A Provincial Income Tax

The Ontario Government intends to establish its own personal income tax system within the next two years. This move to an independent income tax is necessary to preserve the Province's fiscal integrity and to achieve meaningful tax reform in Ontario.

Three developments have led to this decision: the Province's need for greater access to fast-growing revenue sources in order to maintain its existing programs and undertake essential reforms; the impasse in federal-provincial tax sharing; and the inadequacy of the present income tax abatement system to serve Ontario's long-run finance and reform objectives. The first two of these factors have been extensively studied and debated since 1966. Federal-provincial studies and the Province's own projections provide ample documentation that Ontario needs additional tax room in the personal income tax field merely to carry on its existing programs and existing level of support to municipalities. Ontario's responsibility to carry forward provincial programs on the scale required and to increase municipal support magnifies this need for growth tax revenues. Similarly, the federal government's adamant refusal to contemplate a more realistic sharing of income tax revenues is now an accepted platitude. The third consideration, however, warrants more detailed explanation.

Public discussion has often appeared to suggest that the people of Ontario do not presently pay provincial income tax. In fact, the people of Ontario have been paying a provincial income tax for many years. The present provincial income tax is equal to 28 per cent of the federal basic tax, and is collected by Ottawa and returned to the Province. Moreover, if the federal government were willing to accept our offer whereby the Province would assume complete responsibility for certain shared-cost programs in exchange for an additional 20 points of personal income tax, the two governments would have virtually equal occupancy of this field. In any event, under the present income tax abatement system, Ontario is severely limited in terms of the revenues it can realistically derive from the fast-growing and progressive personal income tax field. In the first place, the federal government has effectively pre-empted any significantly increased provincial effort by its own heavy use of this field in recent years. Secondly, the collection agreements which govern this shared-tax field restrict the provinces to across-the-board rate increases when they want to increase income tax revenues. The federal government, meanwhile, reserves to itself all the scope for

raising revenues through changes in the tax base and in the progressive rate structure. At a time when overall income tax rates are already very high, these latter avenues surely are superior to further across-the-board rate increases.

The present system also denies the Province any role in determining the structure and method of income taxation appropriate for Ontario. In this Government's view, the present system is grossly deficient in terms of equity and simplicity. The recent imposition of the retrograde Social Development Tax has seriously compounded these defects. Judging by the federal government's unilateral approach to tax reform, there is no assurance, moreover, that Ontario will have any more of a voice in the upcoming reform of this vital tax area. The present income tax system, therefore, is clearly not working in Ontario's interests, either present or future.

The new personal income tax system, which the Government plans to establish, will have the following features:

- it will aim for greater simplicity and greater progressivity than the present system;
- it will be structured to produce significantly increased revenues and thereby improve the growth potential and the progressivity of Ontario's overall tax mix;
- it will be designed as an integrated personal income tax-tax credit system which coordinates provincial and municipal taxes and allows control over the level and distribution of overall tax burdens;
- it will be both a collection and a payments mechanism, which could eventually be adapted to replace income maintenance programs.

Integration will be achieved through provisions for the deduction of taxes paid by individuals in other provincial and municipal fields from their tax liability under the provincial personal income tax. For example, it will be possible to replace the present Basic Shelter Tax Exemption payments by property tax credits. Such an arrangement would be superior to the present practice in two respects. First, it would channel property tax relief directly back to all taxpayers — homeowners and tenants. Second, the tax credit system offers more scope for redistributing property tax burdens. For example, the property tax credits could be designed to vary with income and family size or could have an upper income cut-off point. Eventually, this form of integration could be extended to incorporate tax credits against payments of retail sales taxes, health insurance premiums, and other provincial taxes which are regressive in impact. An essential adjunct of this integrated personal income tax-tax credit system would be a rebate mechanism to pay refunds

to those taxpayers whose total credits exceed their total personal income tax liability. Such a procedure would represent a move toward a positive income supplement or guaranteed income scheme.

To sum up on the personal income tax, Ontario has decided to establish its own system of personal income taxation rather than continuing with the present abatement system. This course of action will allow the Province to raise necessary provincial funds on a fair and efficient basis. It will open up new scope for the systematic integration of overall provincial-municipal taxation in Ontario and lessen the burden of property taxes on those least able to pay. Whether the federal government is willing to continue cooperation in collection under this new system will be a matter for negotiation. Obviously, a single collection agency for both levels of government would be desirable. Recent events in Ottawa suggest that the Department of National Revenue may be replaced by a tax-collection commission. We would suggest that consideration be given to establishing a federal-provincial tax collection commission, as a joint body to serve both levels of government. On the other hand, the absence of such cooperation certainly will not inhibit the implementation of a new income tax system in Ontario.

2. Taxation of Capital Gains

The Ontario Government intends to tax capital gains when it introduces its provincial income tax. The Government believes that capital gains must be brought into the tax system in order to achieve greater equity between taxpayers with equal incomes and among taxpayers at different income levels. It is recognized that taxation of capital gains could reduce private savings and economic growth in Ontario. However, this potential economic disadvantage is far outweighed by the positive improvement in equity and consistency to be gained by taxing capital gains.

It is Ontario's view that capital gains should be taxed on a uniform basis all across Canada. This requires either a fully integrated system of provincial capital gains taxes, a system of federal and provincial capital gains taxes or a purely federal tax, the revenue of which is shared with the provinces. Ontario is prepared to discuss these options with the federal government and the other provinces to ensure that a harmonized overall system is developed. If the federal government is not prepared to tax capital gains (either in concert with the provinces or on behalf of the provinces as well as in its own right), Ontario, nevertheless, intends to go ahead in this field. In this eventuality, Ontario's rates would have to be nominal, at least until such time as other provinces entered the field.

Ontario believes that the United States capital gains tax provides a reasonable model for designing a capital gains tax appropriate to Ontario and to Canada. Thus, the kind of tax that is envisaged would have the following features:

- taxation of gains when they are realized and upon death or emigration;
- deductibility of losses as an offset against capital gains income;
- no discounting of gains to allow for inflationary effects;
- exemption of gains on homes and other specific forms of real property, up to a lifetime limit, with periodic reassessment of this limit;
- distinction between short-run speculative gains and long-run investment gains;
- concessionary rates of tax on long-run gains and, certainly, rates that are no higher than in the United States;
- fair averaging provisions, both forward and backward.

A capital gains tax structured along these lines would minimize adverse economic effects and be administratively workable, while at the same time increasing government revenues and making the overall tax system more equitable.

3. Succession Duties

The new federal Estate Tax Act limits the range for modification and reform in Ontario's succession duties. Ontario strongly believes that these two taxes should remain as compatible and as harmonized as possible. If the Province were to go its own way in developing the death tax field, as Ottawa already has done, the end result could be confiscatory total tax levels, capricious overall tax consequences and a disproportionate allocation of private resources devoted to compliance and evasion. The responsible options left open to Ontario in respect of succession duties, therefore, narrow down to two: retain the provincial tax and bring it into conformity with the new federal tax, or relinquish this tax field to the federal government in exchange for equivalent revenue. Ontario proposes to relinquish its succession duties in exchange for 75 per cent of the revenues that will accrue in Ontario from full application of the new federal Estate Tax Act.

As capital gains taxation becomes fully mature in the years ahead, undue accumulations of wealth will be moderated. In Ontario's view, therefore, the need for taxation of estates will diminish and such taxation should be gradually eliminated. This could be achieved either by the

federal government, through increases in its level of exemptions, or by the provinces through forgiveness or refund of their shares of estate tax revenues.

4. Taxation of Gifts

With a provincial income tax, it would be feasible for Ontario to establish a provincial gift tax. There is little rationale for such a gift tax, however, once the Province moves out of the succession duties field. Moreover, a provincial gift tax on top of the new federal gift tax would push rates to punitive levels. Ontario, therefore, does not intend to establish its own gift tax.

The Province strongly contends, however, that gift tax revenues should be shared with the provinces. Since the federal government views gifts primarily as reductions in the size of estates eligible for estate taxes, then it is only fair that the provinces share in gift tax revenues to the same extent that they share in estate tax revenues, which is 75 per cent. Again, integration and harmonization to avoid duplication and excessive taxation is the desirable goal.

5. Corporation Income Tax

Ontario's corporation income tax closely parallels Canada's corporation income tax in terms of structure and design. The Province believes that this conformity must be maintained in future, both for reasons of neutrality and simplicity.

On the side of administration and collection, the Province is considering a major change. The Carter Commission, Smith Committee and Select Committee all recommended that administration and collection of the corporation income tax be turned over to the federal government. This Government is persuaded by the obvious merits of such a step. There is no question that administration and collection of corporation income taxes would be more efficient and certain if handled only by a central authority. Personnel from both the provincial corporation tax and succession duties areas would become available to launch the new provincial income tax administration. Before reaching any final decision to turn over corporation income tax collection to the federal government, however, Ontario must be assured that the interests of corporate taxpayers as well as its own interests, and particularly its revenues, will not suffer.

The sales tax on production machinery and the higher capital taxes announced in this budget will raise Ontario's overall level of taxation on corporations substantially. This increased burden was necessary because the business sector, like all other taxpayers, must carry its fair share of

revenue-raising measures. Looking to the future, however, it is apparent that there is little remaining tolerance for further increases in corporate taxation, except perhaps in corporation income tax rates. It must also be recognized that Ontario's rates cannot move far out of line with those in other jurisdictions, both in Canada and abroad, if the province is to remain competitive. Moreover, various studies have supported the contention that such increases are ultimately reflected in the price paid by consumers for goods and services.

6. Mining Taxation

The Government believes that the mining industry has been taxed too lightly in relation to the taxes borne by other industries and sectors of the Ontario economy. The increase in mining tax announced in this budget aims to correct this defect and to secure for all the people of Ontario the revenues which should logically accrue to them from this province's natural resources.

In addition to establishing a proper level of provincial taxation on mines, the plan for reform in this field calls for municipal taxation of mining properties. Beginning in 1970, mining municipalities will be empowered to levy property tax on smelters and other processing facilities. Assessment of these processing facilities is now under way and scheduled for completion before the end of 1969. When fully in effect, this change will add over $10 million a year to the revenues of mining municipalities. Ultimately, many municipalities in the north will share in this additional fiscal capacity through the formation of regional school boards and regional governments. In the meantime, the Province will continue to make payments to mining municipalities out of its general revenue, though at a reduced level and through a revised formula which includes mining workers engaged in extraction operations only. This new approach to mining taxation will result in net benefits to mining municipalities and in broad benefits to Ontario taxpayers in general.

7. Retail Sales Tax

Ontario's long-run financial needs dictate that the retail sales tax remain a major and growing source of revenue for the Province. Both the Smith Committee and the Select Committee recognized this inescapable reality. The thrust of reform in the sales tax area, therefore, must be to ensure that this additional revenue is raised in the most efficient and equitable manner.

Additional revenue from the retail sales tax can only be obtained by broadening the base and/or raising the rate. In this budget, the retail sales tax base was expanded to include three previously exempt areas: production machinery, hotel and motel accommodation, and movie tape and video tape rentals. This leaves little scope for further expansion of

the base except in the area of services and necessities such as food. The Province does not intend to tax food, children's clothing and other necessities, at least until the regressive aspects of such taxation can be deliberately offset by tax credits and refunds under the provincial income tax. Nor does the Province envisage any great expansion in the area of services. The costs of proper administration and collection of the retail sales tax on many services would be high because of the number of vendors involved, while the additional revenues to be gained would be modest. To the extent that Ontario finds it necessary and desirable to derive additional revenue from sales taxation, therefore, it must come primarily through rate increases.

In the present budget the retail sales tax rate on liquor, bottled beer and wine, and meals over $2.50 has been increased to 10 per cent and taxation under The Hospitals Tax Act will be incorporated into The Retail Sales Tax Act. This represents a start in the direction of differential sales tax rates for selected commodities. The Province will continue to explore and develop this avenue before contemplating any general rate increase.

8. Other Provincial Taxes

The 1969 Budget has introduced significant changes in other areas of provincial taxation. The tax on tobacco will be increased, gasoline tax refunds narrowed, and numerous minor changes made to remove nuisance features, reduce collection costs and streamline administration. In the years ahead, Ontario will continue to review and improve its tax policies in these and other provincial fields.

II. REFORM OF PROVINCIAL AID TO LOCAL GOVERNMENTS

The Ontario Government recognizes that the local tax base carries too much of the financing burden for the provincial-municipal sector as a whole. This undue reliance on property taxation is clearly indicated by the continuing financial squeeze on municipalities and the increasing demands for provincial relief. In 1968 the Province undertook two major relief measures suggested by the Smith Committee, the Basic Shelter Tax Exemption payments and the takeover of the administration of justice, shifting approximately $150 million of financing from the local tax base to the provincial tax base. These measures have relieved the pressure on mill rates but do not constitute adequate long-run support. A major reform objective of the Province, therefore, is to increase its financial support for local governments in order to reduce the burden of financing which falls upon the slow-growing and oppressive property tax.

1. Increased Provincial Grants for Education

As a first step, Ontario intends to raise its average level of support for elementary and secondary education to 60 per cent over a three-year period, beginning in 1970-71. Presently, the Province's legislative grants provide about 45 per cent of school board finances. This increase in provincial support of education from 45 to 60 per cent will represent a permanent shift in financing from the local tax base to the provincial tax base. The cost of this shift is estimated to run from $175 million to $250 million annually, by the end of the phase-in period.

The primary purpose of the Province in assuming this increased share of education financing is to permit some compensating reduction in school board levies. In other words, the increase in provinial taxation for school support is expected to be offset substantially by reduced local taxation for school financing. To realize this desirable reduction in local levies, it is imperative that the higher provincial grants be accompanied by restraint in school board spending. In the past, increased provincial grants have been translated almost entirely into higher total expenditures on schools. This need not be the end result in future, however, because enrolments will level off over the next few years. If school boards do not exercise voluntary restraint in spending, this Government will consider establishing machinery, such as a budget review board, to ensure that increased financial aid from the province is passed on to the local taxpayer.

With increased provincial support of school board costs, there is the concomitant requirement of allocating the aggregate grant among the various school boards. Under present arrangements this is handled by the Ontario Foundation Tax Plan formula. This formula will have to be revised in order to generate and distribute the higher level of provincial grants among the new school board units which were established this year.

2. Other Grants to Local Governments

The long-run goal of the Province is to assume a larger share of the financing for other local services as well. This cannot be achieved immediately because the Province simply does not have the financial resources to make increased transfers. As the new provincial tax system begins to produce additional revenues, however, some of these revenues will be transferred to local governments in the form of increased grants and payments. Again, if the end result is simply increased local spending, this will necessitate central review and control measures.

The Government is undertaking a comprehensive review of its grants and aid policies. As the Smith Committee pointed out, some grants are

obsolete and others deserve new emphasis, while in aggregate the present system lacks coordination. The Province hopes to correct these imperfections and to develop a rationalized overall support policy. Two changes already mentioned are examples of the kind of improvements that will be sought. The Basic Shelter Tax Exemption payments will be replaced by some form of tax credits and refunds under the provincial personal income tax, and mining revenue payments will be reduced as some mining municipalities begin to collect their own revenues from mines. In redesigning its grants policies, the Province also will seek to provide more of its total support in the form of unconditional grants, thereby allowing local governments greater autonomy in their budgetary allocations.

Reform of the provincial grants system must inevitably be a long-run process. This is particularly so when the Province is working towards fundamental reforms in other related areas such as property assessment and regional government. The regional government program will simplify and assist the reform of provincial grants in two main ways. First, it will reduce the number of grant-receiving units. Second, the equalization which will occur within regions will reduce the need for equalization components in particular provincial grants. Assessment reform will also have a major bearing on the development of an improved grants system. At present the Ontario Government pays out to local governments approximately $1 billion in grants which in one way or another are based on local assessment figures. Uniform and accurate assessment is vital, therefore, for an equitable distribution of these grants among local governments. Given these interrelationships, some time will be required before a fully adequate and coordinated grants policy can be formulated.

III. REFORM OF LOCAL TAXATION

Property taxation in Ontario stands in need of fundamental reform, perhaps more so than any other area. As the Smith Committee and the Select Committee so clearly showed, the present property tax is grossly unfair and inefficient. The proposed provincial actions to reduce the burden of financing that falls on the property tax and to offset its regressivity via personal income tax credits will substantially ameliorate these shortcomings. But reform of property taxation is still necessary and desirable, both in its own right and in order to facilitate and complement reforms in government structure and provincial grants. Therefore, the Government is determined to overhaul the entire system of property taxation and make it as equitable and efficient as possible.

There are four main thrusts to the Province's plan for reform:

- reassessing all real property at current value;
- broadening of the local tax base by removing exemptions;

- achieving a more neutral business assessment rate; and
- determining an appropriate distribution of tax burdens among classes of real property.

Of these, reform of assessment is the most crucial for it is the foundation upon which subsequent reforms in these other areas must be based.

1. Province-Wide Reassessment at Current Value

Current property assessment in Ontario is riddled with inconsistencies and inequities. Many properties are underassessed, some are over-assessed and some are not assessed at all. Like properties are assessed at different values both within the same municipality and between municipalities. Moreover, there is no consistency among municipalities in the assessment treatment of particular classes of property. A class of property which enjoys low assessment and therefore a tax advantage relative to other properties in one municipality may be at a relative disadvantage in another municipality. The Ontario Government is convinced that the only way to remove these anomalies and inequities is to re-assess all properties in Ontario at current value. It is the Province's aim to bring about uniformity of assessment all across Ontario in order to achieve equity among property owners, among property categories and among municipalities.

To remedy the serious existing problems in assessment, the Smith Committee recommended that Ontario provide more aid and incentives to the municipalities to improve their assessment practices. The Government has doubts that this approach would succeed without a complete change in management practices. It also believes that province-wide re-assessment can be achieved much sooner under provincial management than under local administration. Therefore, the Ontario Government has decided to assume full responsibility for the administration of property assessment. This will be done in two stages. On July 1 of this year, the Province will take over the assessment function in Northern Ontario with the exception of the districts of Kenora, Rainy River and Sudbury and the cities of Sault Ste. Marie and Fort William. On January 1, 1970 the remainder of the province will come under provincial jurisdiction.

This changeover will mean the absorption of present municipal assessment personnel by the Department of Municipal Affairs and assumption of present assessment costs by the Province. This will represent a saving to municipalities of approximately $15 million, allowing a corresponding reduction in provincial grants. Following this imme-

diate step, the Province intends to devote increased resoures to the assessment function in order to ensure that the administration and quality of assessment is brought up to a proper level by the end of 1975.

Apart from the equity and efficiency considerations, this assessment reform will produce one major benefit to local governments themselves. Proper and systematic assessment will bring onto the rolls many properties that at present are not assessed at all or assessed on only part of their value. This will increase the revenues of the municipal sector and broaden the tax base against which future levies can be raised.

As the process of reassessment proceeds, the Province will consider the need for measures to cushion its impact. Present practices vary so widely that the move to a modern and equitable base is bound to involve financial hardships in some instances. While such hardships must eventually be borne if equity is to be achieved, temporary cushioning would smooth and ease these painful adjustments.

2. Broadening the Local Tax Base

The Government recognizes the desirability of broadening the property tax base by removing present exemptions and partial exemptions. Reform along these lines would have three very beneficial impacts on local finance. First, it would increase the revenue-raising capacity of the local government sector as a whole. Second, it would reduce inter-municipal fiscal disparities. Removal of exemptions would increase the assessment base of municipalities which presently have a high proportion of tax exempt properties much more than it would for municipalities with a low proportion of tax exempt properties. Third, it would shift some of the tax burden within each municipality from presently taxable to presently exempt properties.

The major classes of property that are presently exempt or partially exempt are private properties such as churches and YMCA's, institutional properties such as universities and hospitals, and government properties at the municipal, provincial and federal levels. The Province has already announced that it does not intend to remove the exemption for churches. The status of other private properties is currently under review. As for the other categories of exempt properties, the Province believes it would be premature to eliminate exemptions before proper assessment of these properties has been undertaken all across the province.

In the long run, this Government hopes to be able to pay full local taxes on all the properties of the Province, its agencies and the institutions it supports. The Province's recent move to pay full grants in lieu of taxes on senior citizen housing units represents a modest start in

this direction. However, full realization of this objective will not be feasible until revenues become available to finance such reform. This delay, moreover, will permit the Province to consider any relevant findings by the federal-provincial Subcommittee on Intergovernmental Taxation.

3. A More Neutral Business Tax

At present, commercial and industrial properties pay a supplementary business tax as well as a realty tax on their assessed value. This business tax applies different rates of business assessment (that is, different proportions of taxable assessment to total assessment) against different kinds of business; hence, it penalizes some businesses and favours others. As well, the present schedule of rates is replete with categories and definitions which may have been relevant fifty years ago but are totally obsolete and inappropriate today. The Government of Ontario believes that this discriminatory feature of local taxation should be removed. A major reform objective of the Province, therefore, is to establish a more neutral business tax on all commercial and industrial property.

This long-run goal cannot be achieved until all properties, residential as well as commercial-industrial, have been reassessed at current value. Only then will the Province be in a position to measure and evaluate the impact of business assessment rates on different businesses, on different municipalities and on municipal revenues in aggregate. As an interim measure, however, the Province is considering a reduction in the present number of business assessment rates, a narrowing in the present range of rates and a general modernization of the business tax legislation. A transitional reform along these lines would maintain an adequate business tax base during the reassessment period and, at the same time, reduce discrimination between different kinds of business.

4. Distribution of Property Tax Burdens

The local tax reforms already mentioned will work to redistribute property tax burdens in Ontario. For example:

- reassessment will generate major shifts in tax burdens among individual properties, among classes of property and among municipalities;
- to the extent that exemptions from property tax are narrowed, tax burdens will shift from presently taxed to presently exempt properties;
- movement towards a more neutral business tax will redistribute tax burdens among businesses, on a more equitable basis.

In addition, a number of the basic reforms in other areas will have significant impact on property tax burdens. Mine processing facilities will begin to bear property taxes. The increased provincial grants for education will reduce the tax burden on all properties. Regional school boards and regional governments will tend to even out property tax burdens within their respective boundaries. Finally, any personal income tax credits or refunds for property taxes paid will tend to reduce the ultimate burden of residential property taxes on those families and individuals who are least able to pay.

One remaining element of local taxation which affects the weight of tax between residential and commercial-industrial properties is the split mill rate. In principle, the Government favours the abolition of the split mill rate, as was recommended by both the Smith Committee and the Select Committee on Taxation. The Province is not contemplating such a change, however, until reassessment has been completed and the impact on municipal finances can be carefully examined.

Redistribution of property tax burdens could be brought about, of course, by prescribing new norms for various classes of property right from the outset. This is essentially what the Smith Committee and the Select Committee did in setting out new ratios of taxable assessment to total assessment for various classes of property. The Government is convinced, however, that such a policy would be premature and inappropriate. Given the chaotic and discriminatory state of assessment in this province, there can be no reasonable degree of certainty that any desired distribution among property classes would in fact work out in practice. Moreover, the effects in individual municipalities of applying prescribed ratios of taxable assessment to total assessment may be substantially different than the effects for the province as a whole. The Province intends to push on with assessment reform, therefore, before attempting to establish any final distribution of tax burdens.

Within the overall field of property taxation there are some classes of property which merit special tax treatment. Transportation and communication properties, for example, must be considered separately from properties in general. The tax treatment of these special properties is still under review by the Province. Farm properties also require special treatment. Generally, the Government believes that the property tax on working farms should be considerably lower than on non-farm properties, because of the limited ability of working farms to pay taxes out of current income. Therefore, if property taxes on working farms show any significant increase when reassessment is introduced, the Province will consider interim measures to hold the line on farm tax burdens. This does not imply that the Government favours continuous tax concessions to all farms, including farms which are held and sold for land

speculation. It simply reflects the Government's view that a capital gains tax is a better means of deriving the appropriate taxation from such farms rather than penalizing working farms with impossible property tax burdens.

IV. REFORM OF LOCAL GOVERNMENT STRUCTURE

Ontario has embarked on a long-run program to reorganize and reform its local government structure. This reform program seeks to achieve five major objectives:

1. a strengthened and modernized system of local government;
2. greater efficiency in the planning, administration and provision of local services;
3. reduction of disparities among local governments in the level of services and taxation;
4. return of powers to local governments from special-purpose boards and commissions;
5. decentralization and regionalization of provincial programs wherever feasible.

The Province is working to realize these objectives by means of three interrelated and complementary policies: the creation of larger school board units, the consolidation of existing local municipalities, and the establishment of a comprehensive system of regional governments.

The school board policy has already been legislated and implemented. As the new county boards of education become fully operational, some very positive results should begin to emerge. Education services in poorer and more remote areas will be upgraded; the property tax burden of school financing will tend to equalize within counties; and there will be a gradual improvement in the planning and provision of elementary and secondary education across the province as a whole.

The Province is also pursuing an active policy of municipal consolidation in order to reduce the total number of municipalities. A large number of local municipalities in Ontario are far too small to be viable units, either on their own, or within the lower tier of a regional system. Therefore, the Government is working towards a target of larger municipalities. This policy in itself will reduce tax imbalances and improve the efficiency of local governments. Normally, municipal consolidation will occur among lower-tier municipalities at the time of the establishment of a regional government. In areas where regional governments are not imminently planned, however, municipal consolidation will be encouraged on its own merits.

1. Regional Government

The key element in the structural reform program is the establishment of a system of regional governments. These new units will be urban-based in character, to enable local government to cope more effectively with the problems and needs of Ontario's increasingly urban and urbanizing society and to provide a broader range of benefits to our rural areas. The new regional units will also operate on a much broader scale, thereby providing the strength and cohesion which is lacking in the present municipal structure. This strength of the new regional units has three dimensions:

- a geographic area large enough for proper physical and economic planning;
- a population large enough to achieve economies of scale in the provision of public services;
- a financial base adequate and diversified enough to support a reasonable level and range of services.

As regional governments are established, the Province expects to see major progress towards its structural reform objectives. Powers presently in the hands of special-purpose bodies can be turned over to the new regional governments or to constituent local municipalities. The overall efficiency of local government should improve. Intermunicipal fiscal disparities, both in terms of the level of services and of taxation, should tend to even out. This equalization will occur because each regional government will provide a standard level of required services within its boundaries and will draw upon the tax base of the region as a whole for its financing.

The regional government policy will complement and support Ontario's other reform programs Creation of regional governments and reduction in the number of municipalities, for example, will facilitate the development of a rationalized system of provincial aid to local government. Reform of local taxation and the regional government program will be mutually reinforcing; province-wide reassessment will ensure that regional governments are developed from a sound fiscal footing, while the improved assessment balance achieved through regionalization will allow a more equitable distribution of tax burdens among classes of property. In addition, the Province intends to work towards common boundaries for school boards and regional governments.

Regional government will also assume growing significance for the achievement of Ontario's regional economic development policies. The Department of Treasury and Economics and the Department of Municipal Affairs are working closely together to ensure that the two programs are coordinated, complementary, and mutually supporting. The broad pro-

vincial plans for orderly growth and development in all regions of the province will provide an umbrella for the land use and environmental planning responsibilities of regional governments. Regional government boundaries will be used as basic "building blocks" in drawing up more uniform administrative boundaries for provincial departments, which is one of the objectives of Ontario's "Design for Development". Both the regional government and regional development programs are based, essentially, on the concept of urban growth points. The concentration of provincial expenditures at these growth points as a means of encouraging economic growth and development in each region will result in an expansion of the local tax base of these growth centres. Regional governments will perform the key role of distributing these fiscal dividends throughout the region as a whole, thereby benefitting the rural areas as well as the urban centres. In addition, inter-regional equalization will occur through the discretionary regional allocation of the Province's budgetary expenditures and the program activities of provincial departments and agencies, under the regional development program.

This Government intends to implement the regional government program on a staged basis, giving priority to those areas of the province where the need for regional government is most immediate. The first full-fledged regional government came into existence in Ottawa-Carleton on January 1, 1969. The second regional government will be established in Lincoln-Welland, effective January 1, 1970. Other areas where attention is being concentrated are: Halton-Peel; East and North of Metro Toronto; Kitchener-Waterloo; Hamilton; Sudbury; and Muskoka. The timing schedule for Ontario's regional development program calls for definition of the growth points in all ten economic regions by the end of 1969 and the formulation of economic development plans throughout 1969 and 1970.

V. SUMMARY AND CONCLUSION

The four reform programs set out in this paper constitute a complete restructuring of provincial and municipal finance in Ontario. The various reform thrusts are interdependent and complementary; they must be regarded as parts of a total plan, a total "Fiscal Framework for the Future". The changes involved in moving towards Ontario's long-term objectives will be far-reaching and pervasive. The Province intends to implement its reforms, therefore, in measured and coordinated steps, all the while retaining maximum flexibility to consider alternative methods and means.

The Province is convinced that major benefits and improvements will result from its package of fiscal and structural reforms. Provincial and municipal taxation will become more equitable, more efficient and more

capable of producing the revenues Ontario will need for development and expansion of essential public services in the years ahead. A major burden of financing will be lifted from the slow-growing and oppressive property tax. The strengthening and modernization of local governments will enable them to meet their present problems and to cope more effectively with the emerging needs of Ontario's urban society. Finally, existing disparities in levels of public services and taxation across the province should gradually be levelled out.

This white paper represents the framework of Ontario's reform program. A large number of less prominent recommendations in the reports of the Smith and Select Committees have yet to be fully considered before all the details of the reform program can be completed. These recommendations will continue to be reviewed by the Taxation and Fiscal Policy Branch of the Department of Treasury and Economics for possible implementation.

It must be recognized that this reform program will not be costless or painless. As this budget shows, the first step in the program of fiscal reform must be to contain the growth in public expenditures. But even with continuing restraint, total taxation in Ontario must inevitably increase in the years ahead, unless the fiscal mismatch between the federal and the provincial-municipal sectors is corrected. Redistribution of tax burdens also means additional taxes on some individuals, some properties and some businesses. The Province is convinced, however, that the social and economic costs of maintaining our present system, with all its inequities and defects, would be higher still. Ontario must proceed with fundamental reforms, both because of the intrinsic merits of such reforms themselves, and to provide the basis for constructive and rational development of public finance in this province.

Ontario